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No. 1143

In the Supreme Court of the United States

OCTOBER TERM, 1969

MIDWESTERN UNITED LIFE INSURANCE COMPANY,

Petitioner,

vs.

TORA C. BRENNAN,

Respondent.

APPENDICES

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APPENDIX A

District Court Decision on Motion to Dismiss

MEMORANDUM OF DECISION AND ORDER

The complaint in this case alleges a class action for damages against the defendant corporation for aiding, abetting, and assisting, by its failure to report improper activities of a brokerage firm, the alleged violation by the brokerage firm of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and of Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. §240.10b-5. The alleged principal violator, Dobich Securities Corporation, was engaged in selling shares of stock in the defendant corporation, which was acting as its own transfer agent. However, according to the complaint, Dobich failed to deliver stock of the defendant corporation having a value of two million nine hundred thousand dollars ($2,900,000) before Dobich became bankrupt, having used the stock purchase money as working capital for speculation and other improper purposes and having used fraudulent misrepresentations in explaining to purchasers the reason for delays in delivery of the purchased shares of stock. The complaint alleges that the defendant knew of Dobich's activities and permitted the activities to continue by failing to report Dobich either to the Indiana Securities Commission or to the Securities and Exchange Commission. By thus permitting Dobich's activities to continue, alleges the complaint, the defendant knowingly and purposely encouraged an artificial build-up in the market for its stock. As a result of this Dobich-stimulated market, the defendant was allegedly in a more favorable position for potential mergers it was then negotiating.

and certain of the defendant's officers and directors realized substantial personal profits from the sale of stock in the defendant corporation.

On January 13, 1966, the defendant filed motions (1) to dismiss for failure to state a claim upon which relief can be granted, (2) to dismiss the claim in so far as it is a class action, (3) for a more definite statement, and (4) to strike certain parts of the complaint. Extensions of time were granted to both parties for the preparation of extensive and helpful briefs on the issues raised by the motions. A hearing was held on June 9, 1966 on the two motions to dismiss, and at the close of that hearing both parties were granted additional time to file further briefs. After full consideration, this court concludes that all four motions must be denied for the reasons and in the manner hereinafter stated.

I. Motion to Dismiss for Failure to State a Claim

The motion to dismiss for failure to state a claim upon which relief can be granted raises basic, and not yet clearly answered, questions regarding the extent and nature of civil liability under Section 10(b) and Rule 10b-5. The defendant's primary contentions in regard to this motion are (1) that an aider and abettor is not liable, as such, in a civil action for damages under Section 10(b) and Rule 10b-5, (2) that one cannot aid and abet the commission of a wrong unless he does so by some affirmative action or by breaching an affirmative duty to act, and (3) that the complaint does not sufficiently allege the plaintiff's reliance upon the defendant's conduct, or "some semblance of privity" between the plaintiff and the defendant, or some relationship between the plaintiff and the defendant which would show that the defendant's conduct was a proximate cause of the plaintiff's alleged damage.

For purposes of the motion to dismiss, the defendant concedes that the complaint sufficiently alleges a violation of Section 10(b) and Rule 10b-5 by Dobich Securities Corporation. Nor has the defendant challenged the proposition that civil liability for damages arises under the cited section and rule. Such civil liability has become well established in the twenty years since it first appeared in the landmark case of *Kardon* v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D.Pa. 1946). The *Kardon* doctrine has been explicitly approved and adopted in holdings of courts of appeals in five circuits—*Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951); *Speed* v. *Transamerica Corp.*, 235 F.2d 369 (3rd Cir. 1956); *Hooper* v. *Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir. 1960); *Fratt* v. *Robinson*, 203 F.2d 627 (9th Cir. 1953); *Ellis* v. *Carter*, 291 F.2d 270 (9th Cir. 1961); *Crist* v. *United Underwriters, Ltd.*, 343 F.2d 902 (10th Cir. 1965); by dictum of the courts of appeals in two more circuits — *Beury* v. *Beury*, 222 F.2d 464, 465 (4th Cir. 1955); *Brouk* v. *Managed Funds, Inc.*, 286 F.2d 901, 906-908, 913 (8th Cir. 1961); *Boone* v. *Baugh*, 308 F.2d 711, 713-714 (8th Cir. 1962); and applied in the district courts in still two more circuits—*Northern Trust Co.* v. *Essaness Theatres Corp.*, 103 F.Supp. 954, 964 (N.D. Ill. 1952); *Texas Continental Life Ins. Co.* v. *Bankers Bond Co.*, 187 F.Supp. 14, 23 (W.D.Ky. 1960)—including the Seventh Circuit where Judge LaBuy, in the *Northern Trust Co.* case, stated,

> "Without unduly lengthening this memorandum by consideration of the defendant's contentions, the court is of the opinion Section 10(b) authorizes the remedy here pursued."

The *Kardon* doctrine was impliedly approved by the United States Court of Appeals for the Seventh Circuit by its opinion in *Kohler* v. *Kohler Co.*, 319 F.2d 634 (7th Cir. 1963). It appears that there have been no decisions rejecting that doctrine. 3 Loss, *Securities Regulation* 1763-1764 (2d ed. 1961).

Mindful of the fact that the issue of aider and abettor liability under the Securities Exchange Act of 1934 is here raised by a motion to dismiss and that the issue presents important questions in an expanding area of the law, and having due regard for the purposes and policies underlying the Act, it cannot be held necessarily to exclude persons who do no more than aid and abet a violation of Section 10(b) and Rule 10b-5.

In fact, the provisions of Section 10(b) and Rule 10b-5 were applied to aiders and abettors even before the first case recognizing civil liability under that statute and rule. The first case to deal with the applicability of Section 10(b) and Rule 10b-5 to aiders and abettors involved a suit by the SEC for an injunction against alleged principal violators and certain aiders and abettors. The complaint against the aiders and abettors was upheld on a motion to dismiss. The district court cited the criminal provisions making aiders and abettors responsible as principals and stated, "No good reason appears why this same rule should not apply in an injunctive proceeding to restrain a violation of the same statute." *SEC* v. *Timetrust, Inc.*, 28 F.Supp. 34, 43 (N.D. Calif. 1939). The court further observed that, "There is ample authority to support the validity of a suit to enjoin persons who are aiding and abetting the commission of unlawful acts."

The defendant inaccurately contends that the above-cited *Timetrust* case was reversed on its holding that aiders and abettors could be enjoined under Section 10(b). That decision was appealed but the appeal was dismissed on stipulation. 118 F.2d 718 (9th Cir. 1941). The district court then heard evidence and enjoined all the defendants. The granting of the injunctions against the aiders and abettors was reversed because "there is no evidence that they participated in any way" in the unlawful activity. *Timetrust* v. *SEC*, 142 F.2d 744, 746 (9th Cir. 1944). The court of appeals gave no indication that the injunctions would not have been upheld had there been evidence of the alleged aiding and abetting.

In *SEC* v. *Scott Taylor & Co.*, 183 F.Supp. 904 (S.D. N.Y. 1959), another suit for an injunction, the court found that a defendant actively participated in a violation of an SEC rule promulgated under Section 10(b). However, the court added a footnote, by way of dictum, that "Wholly apart from Landau's participation in [the illegal distribution], he aided and abetted the other defendants' violations . . . and is therefore liable as a principal."

In *Fry* v. *Schumacker*, 83 F.Supp. 476 (E.D.Pa. 1947), the court upheld a complaint on a motion to dismiss when the complaint alleged a claim against brokers who had been employed by the principal violators to write a letter which was an essential part of a plan to defraud in violation of Section 10(b) and Rule 10b-5.

The case that is perhaps most nearly in point is *Pettit* v. *American Stock Exchange*, 217 F.Supp. 21 (S.D.N.Y. 1963). This was an action for damages. The court denied motions to dismiss for failure to state a claim upon which relief could be granted and upheld that part of the com-

plaint which, under Section 10(b) and Rule 10b-5, alleged that the defendant stock exchange and its officers aided, abetted, and assisted an illegal distribution of stock "by failing to take necessary disciplinary action" against some of its brokers who it knew or should have known were engaged in abusive conduct and practices. The complaint as upheld also included allegations that other defendants, including some banks, assisted, aided, and abetted by allowing the principal violators to open and maintain dummy accounts and by helping to conceal the true identity of traders in the plaintiff's stock. Judge Palmieri explicitly stated the basis for his holding:

> "Since knowing assistance of or participation in a fraudulent scheme under Section 10(b) gives rise to liability equal to that of the perpetrators themselves, the facts alleged by the [plaintiff] trustees, if proven, would permit recovery under Section 10(b)." *Pettit* v. *American Stock Exchange, supra,* at 28.

The defendant attempts to distinguish this case upon the basis that Section 6 of the Securities Exchange Act of 1934 imposes a statutory duty upon stock exchanges to take certain disciplinary actions. However, the court did not base its decision upholding the aiding and abetting sections of the complaint under Section 10(b) on the duty of the stock exchange under Section 6. The Section 6 duty was the basis of a separate count of the complaint and was considered in a separately labeled and subsequent section of the court's memorandum. Whatever effect the Section 6 duty might have on the alleged aiding and abetting by the stock exchange, which involved no affirmative action, Section 6 would, of course, have no relevance to the alleged aiding and abetting of the other defendants.

The defendant contends that the legislative history of certain amendments proposed, but never adopted, during 1956, 1957 and 1959-60 indicates a Congressional determination that Section 10(b) does not apply to aiders and abettors, and does not impose a civil liability in damages against persons aiding and abetting a violation of Section 10(b). This legislative history sheds little, if any, light on the Congressional understanding of the applicability of Section 10(b) to aiders and abettors. The amendments which would have given the SEC explicit power to enjoin aiders and abettors under the Securities Exchange Act of 1934, as well as under several other Acts administered by the SEC, were part of a package of numerous amendments proposed by the SEC. This package of amendments was never fully enacted by Congress. Some of the amendments, including the aider and abettor amendments to the 1934 Act, were passed by the Senate in 1960, but were never acted on by the House of Representatives. See 1 Loss, *Securities Regulations* 205-206, n. 80 (2d ed. 1961).

The legislative history does indicate that the purpose of the unadopted aider and abettor amendments was "to strengthen and clarify the injunctive power" rather than to add a new element to the power of the SEC. S. Rep. No. 1757, 86th Cong., 2d Sess. 8 (1960). The SEC explained in a memorandum of its General Counsel that the amendment would "make manifest" the responsibility of aiders and abettors, *Hearings on S.* 1178-1182 *Before a Subcommittee of the Senate Committee on Banking and Currency,* 86th Cong., 1st Sess., at 276 (1959). In an official explanation of the proposed amendments, the SEC stated the purpose of the aider and abettor amendment was to "remove the ambiguity" since "there may exist some doubt as to the

Commission's authority to obtain an injunction, or impose administrative sanctions, against persons aiding or abetting violations of the act." *Hearings, id.* at 335. The New York Stock Exchange apparently acceded to this view of the purpose of the amendment and of the SEC's injunctive power under the 1934 Act as it then read. In a statement before the Senate Subcommittee, the Exchange agreed that "this would be a reasonable clarification of the statute" and would "make it clear that an indirect violation of the act is unlawful." *Hearings, id.* at 54. It should also be remembered that at that time the *Timetrust, Scott Taylor,* and *Fry* cases had all been decided. If it was then generally understood that the SEC had injunctive power against aiders and abettors under the 1934 Act, as the legislative hearings on the proposed amendments indicate, the defendant here cannot successfully contend that the failure to pass the clarifying amendment shows a Congressional intent that the Act has no applicability to aiders and abettors. The SEC, in the same amendment package, had sought explicit statutory authorization for certain other items then already judicially recognized. Such requests were not included in the bill reported out of committee specifically because the committee considered such codification unnecessary. S. Rep. No. 1757, 86th Cong., 2d Sess. 9 (1960). Perhaps Congress did not act on the reported bills for the same reason.

The defendant seeks to emphasize the fact that the New York Stock Exchange opposed the particular form of the SEC's proposed aider and abettor amendment because of its fear that adding a provision merely making it "unlawful" to aid and abet a violation of the Act would not only clarify the SEC's injunctive power, but might also

give rise to civil liability in damages on the part of such an aider and abettor. *Hearings, supra* at 54. The SEC's proposed aider and abettor amendment was to have modified Section 20(b) of the 1934 Act, and applied generally to all provisions of that Act. The Exchange proposed that the amendment modify only Section 21(e), which dealt with the SEC's injunctive power. *Hearings, supra,* at 54. A memorandum of the SEC's General Counsel indicates that, at least originally, the SEC intended that its amendments "would make this aiding and abetting principle equally applicable to civil and administrative proceedings." *Hearings, supra* at 275. The SEC, however, apparently felt a stronger interest in clarifying its injunctive powers than in clarifying the extent of civil liability of aiders and abettors, since a memorandum by the Senate Subcommittee staff states:

> ". . . the industry fears that private litigants, not only the SEC, may find in this section a vehicle by which to sue aiders and abettors. For the statute does not say who can sue—it merely says 'it shall be unlawful' (to aid or abet). The courts have extended from the SEC to private plaintiffs a right of suit under a comparably general antifraud provision of the 1934 Securities Exchange Act (sec. 10 (b)).
>
> "*Suggestions of industry agreeable to SEC.*—
>
> Make it clear that no civil liability is intended."

Hearings, supra at 370 and 288.

It should come as no surprise that "the industry" wanted to limit the liability of aiders and abettors, or that the SEC would be satisfied with a provision limited to a

confirmation of its own powers. But the intent of the industry or the acquiescence of the SEC is not necessarily the intent of Congress. The SEC's proposed amendment was modified in the Senate Committee on Banking and Currency as suggested by the New York Stock Exchange. The bill, favorably reported out of committee but never passed by the Congress, would have amended Section 21(e) of the Securities Exchange Act of 1934 as follows:

> "Whenever it shall appear to the Commission . . . that any person is aiding, abetting, counseling, commanding, inducing, or procuring, or is about to aid, abet, counsel, command, induce, or procure such a violation, it may in its discretion bring an action . . . to enjoin such acts or practices and to enforce compliance with this title. . . . The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title."

S. 3770, 86 Cong., 2d Sess., § 20 (1960). This amendment was not enacted by Congress.

The conclusions drawn by the defendant from the legislative history of these amendments rest upon inferences drawn from Congress' inaction on the proposed aider and abettor amendments. The defendant's own line of reasoning could lead to the conclusion that Congress may have failed to enact the Senate Committee's bill because the Committee's modification was a rejection of civil liability on the part of aiders and abettors. See, *e.g.*, the stated reasons for the President's veto of amendments to the Federal Tort Claims Act in 1960. 1 U.S. Code Cong. & Ad. News 1563

(1960). The more realistic view, however, is that the inferences from a mere failure to act are too elusive to provide any reliable guide to the intention of Congress. As Justice Frankfurter stated for the Court in *Helvering* v. *Hallock*, 309 U.S. 106, 119-120, 60 S.Ct. 444, 451 (1940), "To explain the cause of non-action by Congress when Congress itself sheds no light is to venture into speculative unrealities." The courts have wisely and consistently refused to draw such speculative inferences from Congressional non-action. When considering a legislative history strikingly similar to that urged upon this court by the defendant in the instant case, Justice Jackson, speaking for the Court, stated:

> "We draw, therefore, no inference in favor of either constructon of the Act—from the Department's request for legislative clarification, from the congressional committee's willingness to consider it, or from Congress's failure to enact it."

Wong Yang Sung v. *McGrath*, 339 U.S. 33, 47-48, 70 S.Ct. 445, 453 (1950). See also, *FTC* v. *Dean Foods Co.*, 34 U.S.L. Week 4494, 4497-98 (U.S. June 13, 1966).

There may be many reasons why Congress fails to adopt proposed legislation. Particularly where, as in this case, an amendment is part of a package of amendments covering numerous and various aspects of securities regulation, Congress may fail to act for reasons entirely unrelated to many of the individual provisions included within that package. At the time these amendments were being considered, Congress was convened in special session late in the summer of a Presidential election year and much proposed legislation fell victim to a lack of time. It is often

difficult to determine Congressional intent from positive actions of Congress, but it is usually impossible to determine such intent from a failure of Congress to act. To draw any inferences from the action and non-action on these proposed but unadopted amendments by Congress and its committees would indeed be a "venture into speculative unrealities."

Aside from this legislative history, the defendant points out that there is nothing in the statute indicating a Congressional intent to impose civil liability on persons aiding and abetting violations of Section 10(b) and Rule 10b-5. But, likewise, one can search the statute in vain for language indicating that a violator of Section 10(b) and Rule 10b-5 should be liable in a civil action for damages. Such liability was developed by the courts on general principles of tort law. Judge Kirkpatrick in the *Kardon* case, *supra,* cited the Restatement, Torts § 286 (1939) in finding civil liability for the violation of Section 10(b). Such liability was there rested upon the maxim, Ubi, jus, ibi remedium—Where there is a right, there is a remedy. This is the rationale upon which the *Kardon* doctrine has been adopted by the courts of appeals. *Crist* v. *United Underwriters, Ltd., supra* at 903-904. Appropriate general principles of law should continue to guide the development of federal common law remedies under Section 10(b) and Rule 10b-5.

Such general legal principles were the basis upon which the court in *Pettit* v. *American Stock Exchange, supra,* upheld a complaint under Section 10(b) against aiders and abettors. The court there stated that "knowing assistance of . . . a fraudulent scheme under Section 10(b) gives rise to liability equal to that of the perpetrators themselves.

. . . *Pettit, supra* at 28. The principle has been formulated in the Restatement of Torts as follows:

> "For harm resulting to a third person from the tortious conduct of another, a person is liable if he
>
> * * *
>
> "(b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or
>
> "(c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person."

Restatement, Torts § 876 (1939). Such principles as stated in the *Pettit, Timetrust,* and *Scott Taylor* cases, *supra,* and formulated in the Restatement of Torts surely best fulfill the purposes of the Securities Exchange Act of 1934 and are a logical and natural complement to the *Kardon* doctrine.

A basic philosophy of the Securities Exchange Act of 1934 is disclosure and is directed toward the creation and maintenance of a post-issuance securities market that is free from fraudulent practices. The investor's protection is the paramount consideration of much of the federal securities legislation and, in particular, of the 1934 Act here involved. The effect on an investor of an issuer corporation's failure to disclose improper activities of a brokerage firm dealing heavily in the issuer's stock, where the broker's activities create an appreciable risk of loss to that investor, may be just as dangerous and equally as damag-

ing as a failure by the issuer to disclose information of its own improper activities affecting the value of its stock. The loss to the investor may well be the same. This is not to say that there is no distinction between the two types of situations, but is rather to emphasize that a statute with a broad and remedial purpose such as the Securities Exchange Act of 1934 should not easily be rendered impotent to deal with new and unique situations within the scope of the evils intended to be eliminated. In the absence of a clear legislative expression to the contrary, the statute must be flexibly applied so as to implement its policies and purposes. In this regard, it cannot be said that civil liability for damages, so well established under the Securities Exchange Act of 1934, may never under any circumstances be imposed upon persons who do no more than aid and abet a violation of Section 10(b) and Rule 10b-5.

The defendant contends, however, that aiding, abetting, and giving assistance or encouragement necessarily requires an affirmative act. Therefore, reasons the defendant, its own alleged "silence and inaction," *viz.*, the failure to report Dobich's activities to the SEC or to the Indiana Securities Commission, could not make the defendant liable for damages caused by Dobich's wrongdoing. Such a contention, however, oversimplifies both the problem and the answer. The statute under which this action is brought imposes a duty upon persons or corporations who are in a superior position to know crucial and material facts not to take advantage of those who are not in such a position. *Kohler* v. *Kohler Co.*, 319 F.2d 634, 637 (7th Cir. 1963). In the *Kohler* case, at page 642, the Court of Appeals for the Seventh Circuit defined the duty of "insiders" under Section 10(b) as a general principle:

> "[Section 10(b) and Rule 10b-5] basically call for fair play and abstention on the part of the corporate insider from taking unfair advantage of the uninformed outsider or minority stockholder."

The court also pointed out that such duties applied not only to "majority stockholders of corporations and corporate insiders, but equally to corporations themselves when acting through their officers, directors or agents." *Kohler, supra* at 638.

It should be noted that the general principle formulated by the Court of Appeals is not limited merely to minority shareholders, and the duty of insiders was not merely a duty to uninformed outsiders "with whom they deal." In the instant case, of course, the defendant corporation did not seek any advantage directly from the various purchasers of stock from Dobich Securities Corporation. Rather, the advantage alleged to have been desired by the defendant was to have inured to defendant by virtue of being able to assert a stronger position in merger negotiations then allegedly in progress with other persons and/or corporations. This does not mean, however, that the purchasers from Dobich were not taken "unfair advantage" of within the meaning of the *Kohler* case, *supra*. An insider can breach its duty of "fair play" to outsiders even though the advantage desired by the insider is to be gained from others. It is true that the facts which are required to be divulged in the typical insider-outsider stock transaction concern the facts of the corporation's condition which may affect the value of the stock rather than facts about a broker's improper conduct, as in the instant case. It is also true that the insider and outsider deal directly with

each other in the typical case rather than entirely through an independent brokerage, as in the instant case. It does not necessarily follow, however, that the duty under Section 10(b) should be so narrowly confined. The duty of "fair play and abstention . . . from taking unfair advantage of the uninformed outsider" arises under Section 10(b) and should be construed according to the broad and general provisions of that section rather than limited to the specific facts of one case to which the duty was found applicable. The Court of Appeals indicated that the duty should not be so limited when it cautioned:

> "What are the limits of those duties? We are satisfied that the answer cannot be confined to an abstract rule but must be fashioned case by case as particular facts dictate."

Kohler, supra at 637-638.

Certainly, not everyone who has knowledge of improper activities in the field of securities transactions is required to report such activities. This court does not purpose to find such a duty. Yet, duties are often found to arise in the face of special relationships, and there are circumstances under which a person or a corporation may give the requisite assistance or encouragement to a wrongdoer so as to constitute an aiding and abetting by merely failing to take action. See *Pettit, supra.* The question raised by the motion at bar is whether the allegations in the complaint will permit evidence which may establish such circumstances in the instant case. This court holds that they do.

The alleged misrepresentations of Dobich certainly come within the prohibitions of Section 10(b) and Rule 10b-5. The defendant has conceded this for purposes of the motion

to dismiss. The plaintiff was no less defrauded by the misrepresentations of Dobich than she would have been by misrepresentations as to the condition of the corporation and the value of the defendant's stock. The complaint alleges that the defendant knew of Dobich's conduct and alleges circumstances under which it would be possible to conclude that the defendant was an "insider" in so far as it was in a superior position to determine the nature and the propriety of Dobich's conduct. The complaint further alleges that the defendant took advantage of the artificial market for its stock in certain merger negotiations then taking place and that certain of the defendant's officers and directors took advantage of the increased stock values by selling a large number of their shares at a substantial profit.

Whether or not the defendant's alleged "silence and inaction" was sufficient assistance or encouragement to constitute an aiding and abetting of Dobich's alleged violation of the statute and rule cannot be decided on the pleadings. These are questions of fact to be determined at the trial. To rest the definition of aiding and abetting solely on abstract and mechanical distinctions between active and passive assistance or to hold blindly that silence and inaction cannot constitute aiding and abetting under any possible set of circumstances would be to defeat and hamper the intelligent and responsible development of the law by subjecting it to a tyranny of labels. Where recovery may be possible, the pleadings should be upheld so that the facts can speak for themselves. In this regard the Supreme Court has stated:

> "In appraising the sufficiency of the complaint we follow, of course, the accepted rule that a complaint

> should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of this claim which would entitle him to relief." *Conley* v. *Gibson*, 355 U.S. 41, 45-46 (1957).

This is not to hold that silence and inaction under all circumstances, or even under the circumstances which may be developed from the evidence in this case, constitutes aiding and abetting. This is merely to find a sufficient basis in the pleadings to permit evidence that may establish conduct which under the particular circumstances does constitute aiding and abetting. The warning by the Court of Appeals in the *Kohler* case that the extent of such duties "cannot be confined to an abstract rule but must be fashioned case by case as particular facts dictate" is most appropriate here. The very fact that this case arises in a newly developing area of law cautions that the court should refrain from abstract and premature legal determinations fashioned in an evidentiary vacuum.

The defendant's remaining contentions in support of its motion to dismiss for failure to state a claim upon which relief can be granted are without merit. The complaint specifically alleges that the plaintiff relied upon the misrepresentations of Dobich, whose conduct the defendant is alleged to have aided and abetted. Likewise, the complaint specifically alleges that Dobich's conduct proximately resulted in the damages to the plaintiff and other persons similarly situated. Finally, there is no requirement of privity between plaintiffs and defendants, nor of any "semblance of privity," for recovery in Section 10(b) actions. *Miller* v. *Bargain City, U.S.A., Inc.*, 229 F.Supp. 33 (E.D.Pa. 1964); *Cooper* v. *North Jersey Trust Co.*, 226

F.Supp. 792 (S.D.N.Y. 1963); *Pettit* v. *American Stock Exchange, supra; Errion* v. *Connell,* 236 F.2d 447 (9th Cir. 1956); *Fishman* v. *Raytheon Mfg. Co., supra; Texas Continental Life Ins. Co.* v. *Bankers Bond Co.,* 187 F.Supp. 14, 24-25 (W.D.Ky. 1960); 3 Loss, Securities Regulation 1767-1771 (2d ed. 1961).

II. Motion to Dismiss the Class Action

During the pendency of this action, the Federal Rules of Civil Procedure have been amended. Rule 23, governing class actions, has been entirely rewritten. In its order transmitting these amendments to Congress on February 28, 1966, the Supreme Court provided that the amendments

> "shall take effect on July 1, 1966, and shall govern . . . all further proceedings in actions then pending, except to the extent that in the opinion of the court their application in a particular action then pending would not be feasible or would work injustice, in which event the former procedure applies."

383 U.S. —— (1966). There is no reason why application of the new Rule 23 would be unjust or not feasible in this case, and counsel for both parties have so indicated in oral argument. Therefore, the amended Rule 23, effective July 1, 1966, must govern the determination of the appropriateness of this case as a class action.

This case is maintainable as a class action under Rule 23(b)(3). The requirements of Subdivision (a) of Rule 23 are all fulfilled. There appear to be more than five hundred purchasers from Dobich who allege or may allege claims against the defendant similar to the claims alleged by the plaintiff, Tora C. Brennan. There appears to be no reason why the plaintiff will not fairly and adequately protect the interests of these purchasers. The plaintiff

Brennan herself has a substantial interest in this litigation, is represented by able counsel, and is close enough to the forum to assure convenient access during this litigation. Under Rule 23(c)(2) any member of the plaintiff's class who is not satisfied with the adequacy of the plaintiff Brennan's representation may exclude himself from this action by appropriate notification under that subdivision of Rule 23, or may, if he desires, enter an appearance through his own counsel. Rule 23(c)(2). The court itself may assure the protection of the interests of all alleged members of the class to whom notice shall be sent by appropriately describing the members of the class in its order of final judgment as provided in Subdivision (c)(3) of Rule 23.

The determination that this action shall proceed as a class action is made in light of the present posture of this litigation. There has thus far been no pre-trial discovery, and this court has only the complaint and the papers on the instant motion to look to for guidance on the question of the appropriateness of the class action. If, however, as the case develops, it becomes apparent that the questions of fact and/or law are so dissimilar, as between members of the class represented by plaintiff, so as to render the class action unmanageable, the court has the authority under amended Rule 23(c)(1) and (d) to alter or amend its order and to either strike the class allegations from the complaint, subdivide the class, or make such other order as may be proper under the circumstances and as justice requires. That the court has this authority under the express language of amended Rule 23(c)(1) was recently confirmed by Judge Palmieri in *Kronenberg* v. *Hotel Governor Clinton*, reported August 23, 1966 in 35 U.S. Law Week 2096. *Kronenberg* involved a class action by pur-

chasers of shares of stock alleging fraudulent misrepresentations. The court rejected the defendant's contention that the alleged misrepresentations were too varied to meet the requirement of amended Rule 23(b)(3) that there be predominating questions of law or fact common to the members of the class, and rejected the defendant's argument that the plaintiffs did not adequately represent the class, relying in both instances on the flexibility of the new rule in permitting the court's class action determination to be conditional. And the Advisory Committee's Note accompanying the new Rule 23 states that under the new rule:

> "A fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action, and it may remain so despite the need, if liability is found, for separate determination of the damages suffered by individuals within the class."

This court finds that common questions of law and fact concerning the claims of this class of plaintiffs predominate over whatever questions may variously affect only the individual members of the class. The primary legal and factual question in this case is whether the defendant aided and abetted Dobich's alleged violation of Section 10(b) and Rule 10b-5. This issue is identical as to all claimants in the plaintiff's class. Even consideration of the question whether Dobich violated the statute and rule and at what time Dobich's wrongful conduct began, if there was any violation, involves questions of fact which are essentially common to all the purchases to whom Dobich allegedly failed to make delivery of the defendant's stock. At this posture of the litigation, there do not appear to be "material variations in the representations made or in the kinds or degrees of reliance" by the various members of

the class, which the Advisory Committee's Notes to the new Rule 23 indicate would mitigate against the maintenance of a class action in a fraud case.

This does not, of course, relieve any member of the plaintiff's class from the necessity of proving all elements essential to his or her recovery. If it should subsequently appear that certain issues in this case are not appropriately determinable in a class action, the court can modify the nature of this class action and confine it to particular issues as contemplated by amended Rule 23. Elements necessary to recovery, but not appropriate for common determination in the class action—such as, but not limited to, the amount of damages to which each individual member of the class is entitled if liability is established—will be determined separately and individually in proceedings, the nature of which can better be determined at a later date. Under the flexibility of the new Rule 23, it is not likely that the administrative difficulties will outweigh the advantage of handling in one action the similar claims of hundreds of purchasers based upon essentially similar or identical circumstances. To handle the potential litigation by several hundred separate trials would raise administrative difficulties far exceeding those present in this class action. This court also finds at this time that a class action, under the particular pleadings of this case, is superior to any other available method for the fair and efficient adjudication of the claims of the members of the plaintiff's class.

The court will direct the plaintiff to prepare a form of notice which will fulfill the requirements of Subdivision (c)(2) of Rule 23 and to present such form to the court for its approval. The plaintiff will also be directed to furnish the court the names and addresses of all alleged members of the plaintiff's class. The form of notice must in-

form each member of the plaintiff's claim (1) that the court will exclude him from the action if he requests exclusion on or before a specified date, (2) that the final judgment in this action, whether or not favorable to the individual class member, will include all members of the class who do not request exclusion, and (3) that anyone so notified and who does not request exclusion may, if he desires, enter an appearance in this action through his counsel.

III. Motion for More Definite Statement

The nature of the information sought by the defendant in its motion for a more definite statement can appropriately be obtained through the discovery procedures provided for in the Federal Rules of Civil Procedure. The complaint gives ample notice of the plaintiff's claim and is not so vague or ambiguous that the defendant cannot reasonably be required to frame an answer. Fed. R. Civ. P. 12(e). Rule 9(b) of the Federal Rules of Civil Procedure, requiring particularity in pleading the circumstances constituting an alleged fraud, is satisfied by the complaint in its present form. The complaint also makes explicitly clear that the action is based upon Section 10 of the Securities Exchange Act of 1934. The motion for a more definite statement will be denied.

IV. Motion to Strike

Paragraph 1 of the defendant's motion to strike is addressed to all references in the complaint which refer to this case as a class action. Since the defendant's motion to dismiss the class action is being denied, it would be inappropriate to strike the plaintiff's references to the class action.

The allegations of Paragraph 16 of the complaint, "which set out approximately 18 specifications of instances when

the defendant allegedly received information from inquiring purchasers which, it is alleged, gave it notice of Dobich's violations of Section 10(b) and Rule 10b-5," are not redundant or immaterial, nor is the defendant prejudiced in any way by having such allegations included in the complaint.

The motion to strike the allegations that the defendant "should reasonably have known" or "should have known" in Paragraphs 16(h) and 19 of the complaint and the request for attorneys fees will be denied with leave to raise these issues at the pre-trial conference.

ORDER

The defendant's motion to dismiss the action for failure to state a claim is denied.

The defendant's motion to dismiss the class action is denied. The plaintiff is directed to prepare a form of notice which will fulfill the requirements of Subdivision (c)(2) of Rule 23 as discussed in the foregoing Memorandum of Decision and to present such form of notice to the court for its approval. The plaintiff is also directed to furnish the court the names and address of all alleged members of the plaintiff's class.

The defendant's motion for a more definite statement is denied.

The defendant's motion to strike certain portions of the complaint referring to the class action and to strike Paragraph 16 of the complaint is denied. The defendant's motion to strike the allegations referring to the defendant's alleged state of knowledge and to strike the plaintiff's request for attorneys fees is denied with leave to raise these issues again at the pre-trial conference.

APPENDIX B

District Court Decisions On The Merits

MEMORANDUM OF DECISION AND JUDGMENT

This is a class action in which the plaintiff and members of her class seek damages against the defendant corporation for allegedly aiding, abetting, and assisting a securities dealer in the alleged violation by the securities dealer of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and of Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5. This court has jurisdiction under Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa.

In an order entered September 23, 1966, which is reported at 259 F.Supp. 673, this court denied, inter alia, the defendant's motion to dismiss plaintiff's complaint for failure to state a claim upon which relief could be granted. No good purpose would be served by repeating in detail here the matters discussed in that order. At that time the court, considering only the complaint and motion to dismiss, held, first, that it could not be said that civil liability could never under any circumstances be imposed upon persons who do no more than aid and abet a violation of Section 10(b) and Rule 10b-5. The court held, second, that there might be circumstances under which a person or corporation may, by merely failing to take action, give the requisite assistance or encouragement to a wrong does so as to constitute an aiding and abetting. The court then held that the pleadings presented to the court contained a sufficient basis to permit evidence that might establish conduct which under the circumstances would

constitute an aiding and abetting. The principles discussed in that order are applicable to the facts disclosed by the evidence, and, to the extent they are relevant, they are incorporated herein by reference.

A trial was held to the court, without the intervention of a jury, beginning January 3, 1968. The court has concluded, after full consideration, that the plaintiffs have shown conduct on the part of Dobich Securities Corporation which constituted a flagrant violation of Section 10(b) and Rule 10b-5. The court has also concluded that the plaintiffs have shown affirmative conduct on the part of the defendant which, under the facts, and circumstances of this case, constituted an aiding and abetting of Dobich's violation for the purpose of obtaining a benefit for the defendant. This aiding and abetting caused the losses sustained by the named plaintiff and those members of her class who purchased shares of stock in the defendant corporation on or after December 1, 1964 from Dobich Securities Corporation and did not receive delivery of the shares.

In its order denying defendant's motion to dismiss, this court said in part:

> "This is not to hold that silence and inaction under all circumstances, or even under the circumstances which may be developed from the evidence in this case, constitutes aiding and abetting. This is merely to find a sufficient basis in the pleadings to permit evidence that may establish conduct which under the particular circumstances does constitute aiding and abetting. . . ." 259 F.Supp. at 682.

The correctness of that holding is now clear, because the evidence discloses *affirmative conduct* on the part of the defendant which constituted an aiding and abetting

of Dobich's violation of the Securities Exchange Act of 1934. Therefore, it has not been necessary to the holding of the court to decide whether mere "silence and inaction" under the unusual circumstances of this case constituted aiding and abetting which caused the alleged damages. However, since under the evidence and the law the defendant's failure to report would constitute an independent basis of recovery and the parties have extensively briefed this question, it has been given consideration in this opinion.

Prior to the trial of this case, the parties entered into extensive discovery and voluminous stipulations. When the trial commenced, both sides were well aware of the evidence upon which each side has based its claims or defenses. If in any respect the pleadings do not strictly conform to the evidence, no prejudice to either side could have resulted therefrom.

The class of plaintiffs in this action, of which the plaintiff Tora C. Brennan is a member, claim to have purchased from Dobich Securities Corporation, and to have paid for, shares of common stock of the defendant, Midwestern United Life Insurance Company (hereinafter MULIC). The purchases involved in this action were in the secondary market for MULIC shares; that is, the market for shares already issued and outstanding. Throughout the period of time which is involved in this lawsuit, MULIC acted as its own transfer agent. The plaintiffs in this action claim that they never received from Dobich the shares of MULIC stock which they purchased and paid for. The Dobich Securities Corporation filed a petition in bankruptcy July 14, 1965. The bankrupt's insolvent estate is worth but a small fraction of the value of the shares in MULIC which

Dobich sold but failed to deliver. The claims involved in this lawsuit are alleged to involve 419 individuals who claim losses totaling $2,104,904.75. However, as previously indicated only a portion of plaintiff's class will be entitled to recover — those who purchased on or after December 1, 1964.

The Dobich Securities Corporation was formed October 16, 1963, as successor to a sole proprietorship run by one Michael Dobich and known as the Dobich Securities Company. ("Dobich" as hereinafter used will refer to either or both Michael Dobich and Dobich Securities Corporation.) The Corporation was registered as a broker-dealer with the Indiana Securities Commission, but not with the United States Securities and Exchange Commission.

The method of operation of the Dobich Securities Corporation and its predecessor was to concentrate its sales efforts in the secondary market for the common shares of one particular life insurance company. Thus, the corporation or its predecessor concentrated first in the stock of Bankers Life Insurance Company, then Wabash Life Insurance Company, then First United Life Insurance Company, and finally, beginning in the spring of 1964, MULIC. The general procedure followed by the corporation was to solicit orders for a particular stock through a staff of salesmen and to accept payment for these shares, either in cash or in the form of other securities, before actually purchasing the shares for delivery. This pattern of selling a share which the corporation did not yet own is known as a "short sale." Delivery of shares pursuant to these orders was made in numerous instances, after varying periods of delay, by purchasing the shares in the over-the-counter market.

The funds which Dobich Securities Corporation acquired through these "short sales" were applied predominantly in three ways: Payment of operating expenses, speculation in corporate securities for Dobich's own account and in his own name, and speculation in commodities, also for Dobich's own account. The results were disastrous. Between January 1, 1964 and July 14, 1965, the corporation paid approximately $615,000 in commissions, plus a salary and "officer's commission" to Michael Dobich totaling $167,000. Operating expenses as a whole totaled $99,000. Speculations in corporate securities during this period for Dobich's own account produced a net excess of losses over gains of at least $465,000. Speculations in commodities during this period, with the funds of Dobich's customers but for Dobich's own account, produced a loss of $224,000. In addition, the short sale transactions in the stock of the various life insurance companies in which Dobich specialized also produced substantial losses — $140,000 in Wabash Life, $189,000 in First United Life, and $109,000 on the 48,409 shares of MULIC which Dobich actually did deliver. Dobich Securities Corporation produced during its short lifetime actual estimated liabilities of $2,700,000 and assets, other than insurance proceeds, of only $228,942. In all, Dobich failed to make delivery on short sales of approximately 36,000 shares of MULIC, for which customers paid Dobich approximately $2,900,000.

Even if all the assets of the Dobich Securities Corporation are accepted at the values given on the corporation's financial statements, the corporation was insolvent in the sense that its liabilities exceeded its assets as early as March 31, 1964. On that date it had a deficit net worth of $92,000. By August 31, 1964, the deficit had grown to

$479,000, again assuming that all the assets stated on the balance sheet were worth what the statement claimed them to be worth. By December 31, 1964, the deficit net worth was $1,600,000. By July 14, 1965, the deficit was approximately $2,500,000. Growth in the balance of short sales (that is, sales of securities the corporation had not yet purchased) was equally spectacular. Short sales grew from $303,245 on January 1, 1964 to $875,985 on March 31, to $2,246,320 on August 31, to $2,529,710 on December 31, and finally to $3,142,842 on July 14, 1965.

To summarize, the Dobich Securities Corporation was in deep financial difficulties as early as March 31, 1964, and possibly much earlier. In what appears now to have been a desperate effort to recover, Dobich made short sales of MULIC stock in enormous quantities and used the proceeds in stock and commodity speculations for his own account, which only drove the corporation deeper into debt. Michael Dobich was killed in a helicopter crash on July 10, 1965, and the petition in bankruptcy of Dobich Securities Corporation was filed on July 14, 1965.

As might have been expected with such an enormous balance of short sales, the length of time which Dobich Securities Corporation required to make delivery of stock certificates was much greater than normal or customary. Dobich salesmen offered various explanations to customers. These explanations originated at sales meetings and were given to the salesmen by Jack Kitzmiller and A. J. Moore, two sales employees of the Dobich corporation, and occasionally by Dobich himself. In addition, the corporation sent out a large number of letters in the United States mails and telegrams which, inter alia, offered explanations

in regard to slow deliveries. A typical letter to a purchaser of MULIC stock in the early fall of 1964 would acknowledge the purchase and promise delivery in four to six weeks. Some of the persons who received those letters but who did not receive their stock prior to October 24, 1964, received telegrams from Michael Dobich urging the purchaser not to be alarmed about lateness of delivery and promising a letter of explanation. About October 31, 1964, the telegrams were followed by letters. (In these letters Dobich said,

> "Our initial step in this endeavor has been accomplished and we can now revert to catching up on the details. You may not have received your certificate as yet; if not, it will be coming."

Those who purchased MULIC stock from Dobich after October 23, 1964 received letters which did not make any specific promise as to the date of delivery. They did contain this paragraph:

> "Please do not become alarmed if delivery is made later than usual because we are creating a heavy interest in this particular stock. The unusually large volume has two effects; it makes our processes a little slower and at the same time, it causes your holdings to increase in value. . . ."

In general, these letters and telegrams reveal a substantial effort to mislead Dobich's customers by lulling them into a false sense of security. They were led to believe that late delivery was merely a product of administrative difficulties. Purchasers were not told that Dobich did not own the particular shares they were purchasing, that Dobich had a tremendous balance of short sales of MULIC stock, or

that Dobich was insolvent. Such information under the circumstances then existing would obviously have been highly material to any purchaser from Dobich. In conducting these activities, Dobich used the United States mails, interstate Western Union Telegraph Facilities, and facilities of national securities exchanges.

Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. §78j, makes it unlawful for any person,

> "by the use of any means of instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

By the authority of the above section, the Securities and Exchange Commission has promulgated its Rule 10b-5, 17 C.F.R. §240.10b-5, which provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary

in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

It is completely clear that the course of conduct engaged in by Dobich Securities Corporation throughout the period of its dealings in MULIC stock constituted a flagrant violation of the above provisions.

It is now well established that a securities dealer who does business with the public, even at arm's length, impliedly represents that he will deal fairly with the public. 3 Loss, *Securities Regulation* 1483 (2d ed. 1961). See *Charles Hughes & Co., Inc.* v. *SEC*, 139 F.2d 434 (2d Cir. 1943) *cert. den.* 321 U.S. 786, 64 S. Ct. 781 (1944). This implied representation of fair dealing is sometimes known as the "shingle theory."

Dobich Securities Corporation violated this implied representation of fair dealing in several ways. It engaged in transactions with customers while insolvent and without disclosing this crucial fact to its customers. This fact, without more, renders the sale of MULIC stock by Dobich under the facts of this case a violation of Section 10(b) and Rule 10b-5. *In the Matter of Fliederbaum, Mooradian & Co.*, SEC Sec. Exch. Act Rel. No. 7176 (Nov. 29, 1963), CCH Fed. Sec. L. Rep. (1961-1964 Transfer Binder) ¶76,-951. See *SEC* v. *Universal Service Association*, 106 F.2d 232 (7th Cir. 1939), *cert. den.* 308 U.S. 622, 60 S. Ct. 378 (1940); *SEC* v. *C. H. Abraham & Co.*, 186 F.Supp. 19 (S.

D. N. Y. 1960); 3 Loss, *Securities Regulation* 1508 (2d ed. 1961). In addition, Dobich failed to disclose to its customers the tremendous short interest it had built up in MULIC stock, a factor which if disclosed might have influenced customer evaluations of Dobich's recommendation to buy MULIC and customer decisions to make their MULIC purchases from Dobich. See 3 Loss, *Securities Regulations* 1504 (2d ed. 1961). Also, Dobich failed to disclose, prior to completion of sales to customers, its intention not to execute the orders and deliver the shares within the period customary in the industry. This disclosure, too, undoubtedly would have influenced customer decisions. See Bromberg, *Securities Law:* Fraud 94 (1967); 3 Loss, *Securities Regulation* 1488 (2d ed. 1961). *Cf. Stephens* v. *United States,* 41 F.2d 440 (9th Cir.), *cert. den.,* 282 U.S. 880, 51 S. Ct. 84 (1940). In cases where Dobich did disclose that delivery would be later than usual, the disclosure was not made until after the customer had placed his order and paid his money. All of these failures to disclose constituted a course of conduct in flagrant violation of Dobich's implied representation, upon which the public relied, that Dobich would deal fairly with the public.

The Securities and Exchange Commission has given explicit recognition to these principles. Sec. Exch. Act Rel. No. 34-6778 (April 16, 1962), 27 F.R. 3991, CCH Fed. Sec. L. Rep. ¶22,696. This release declares that the Commission considers it to be a violation of, inter alia, Section 10(b) and Rule 10b-5 for a dealer not to clearly disclose prior to the sale its intention not to deliver the security promptly. The Commission's interpretation of Section 10(b) and Rule 10b-5 is clearly appropriate in the public interest and for the protection of investors within the standard set down by

Congress in Section 10(b). This interpretation of Section 10(b) and Rule 10b-5 gives effect to the Congressional purpose of outlawing fraudulent conduct in the sale of securities by requiring full disclosure of matters which the customer might consider material, and thereby preventing the dealer from taking unfair advantage of the customer's lack of information.

In addition to Dobich's repeated violations of its implied representation of fair dealing, Dobich engaged in a continuing effort through letters and telegrams to induce purchasers of MULIC stock not to inquire into the causes of late delivery. Dobich attempted to forestall inquiry by deliberately misrepresenting that the lateness in delivery was merely a product of administrative difficulties.

This court held in its opinion denying defendant's motion to dismiss, 259 F.Supp. at 680, that civil liability for violations of Section 10(b) and Rule 10b-5, under the doctrine of *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), must be grounded upon general principles of tort law. In *Tcherepnin* v. *Knight*, 389 U.S. 332, 88 S. Ct. 548 (1967), the Supreme Court, speaking with reference to a claim for civil relief for violations of Section 10(b) and Rule 10b-5, held that ". . . The Securities Exchange Act quite clearly falls into the category of remedial legislation." 88 S. Ct. at 553. It appears clear therefore that the courts should maintain the same alertness to provide remedies for violations of Section 10(b) which the Supreme Court found in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 84 S. Ct. 1555 (1964) to be necessary to carry out the Congresional purpose in enacting Section 14(a) of the same Act.

The concept of aiding and abetting, as it has evolved in the law of torts, has been formulated in a most helpful manner in the *Restatement of Torts* § 876 (1930), which provides in part:

> "For harm resulting to a third person from the tortious conduct of another, a person is liable if he . . . (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself. . . ."

After a careful and exhaustive consideration of the evidence in this case, the court finds that MULIC engaged in an affirmative course of conduct which aided and abetted Dobich's violations of Section 10(b) and Rule 10b-5.

To understand why MULIC's conduct was a substantial assistance and encouragement to Dobich, it is necessary to examine in substantial detail the relationship between MULIC and Dobich as it developed beginning in May of 1964.

The first significant contact between Dobich Securities Corporation and any officers or employees of MULIC came as a result of a telephone call sometime in mid-May of 1964 from F. H. Dellwo, a MULIC shareholder, to Phil J. Schwanz who was then and now is president of MULIC. In this telephone call, Dellwo reported to Schwanz the essence of a conversation which Dellwo had with a salesman from Dobich Securities Corporation. In response to a request from Schwanz, Dellwo set down the substance of his conversation with the Dobich salesman in a letter to Schwanz dated May 19, 1964. In this letter, Dellwo told Schwanz that the Dobich salesman, a Mr. Robert D. Call, had represented to Dellwo these things: That Dobich "works one stock at a time"; that Dobich claimed credit

for a recent increase in the price of Wabash Life Insurance Company; that the increase was over and Wabash would soon decline; that MULIC was then secretly negotiating an acquisition of First United Life Insurance Company; that Dobich Securities Corporation had acquired 1,000 shares of MULIC; that MULIC would soon enjoy an increase in price; and that in six months MULIC would "top out" at $135 per share (which was at least $65 above its then current market price). In addition, the salesman quoted prices for both MULIC and Wabash Life which were well above the then current market.

Schwanz then discussed the content of the letter from Dellwo with Ralph Sheets, who was then and now is full-time general counsel for MULIC and who is now a vice president of MULIC. Schwanz and Sheets determined that the Dobich salesman had misrepresented to Dellwo a number of things. First, Schwanz testified that he is sure they checked the stockholder ledger and learned that Dobich held no MULIC stock of record at that time. Dobich's stock ledger cards are in evidence as Plaintiff's Exhibit 7 and they confirm this. Second, MULIC had no specific plans at that time for acquisition of First United Life Insurance Company. Third, Schwanz and Sheets saw no reason to expect the price of MULIC to rise to $135 per share as had been represented to Dellwo. Finally, Schwanz and Sheets viewed as excessive the spread above the then current market price which Dobich apparently was seeking to obtain for MULIC stock.

Because of these apparent misrepresentations originating with Dobich, Schwanz and Sheets decided to contact the Indiana Securities Commission. They secured Dellwo's permission to use his letter. Then, on May 26, 1964, with

Schwanz' approval, Sheets sent to the Indiana Securities Commissioner, Martin K. Edwards, a copy of the letter from Dellwo, together with MULIC's own letter explaining that the rumor of MULIC's acquisition of First United was without foundation and that Dobich's asking price for MULIC stock was well above the then current market. Sometime shortly after June 2, 1964, Sheets received a copy of a letter sent from Thomas Mote, Deputy Securities Commissioner, to Michael Dobich directing Dobich and his salesman, Robert Call, to answer the allegations contained in the letter to the Commission from Sheets.

On June 5, 1964, Sheets met Michael Dobich for the first time. Dobich came to Sheets' office at MULIC headquarters in Fort Wayne to obtain a copy of the letter which Dellwo had sent to Schwanz and which Sheets had forwarded to the Indiana Securities Commission. Sheets refused to give Dobich a copy of Dellwo's letter because he was unable at the time to secure Dellwo's permission. Dobich then left, without discussing anything else of significance. Sheets then wrote Dellwo, informing him of Dobich's visit.

On June 22, 1964, Thomas Mote, the Deputy Securities Commissioner, wrote Sheets and informed him of the outcome of an informal hearing which had been held with Dobich and Call on June 15. Sheets was informed that Dobich claimed he was no longer using the rumor concerning MULIC's acquisition of First United Life and that Dobich had been warned against the use of "rumors" and "unreasonable spreads." The closing paragraph of the letter reads as follows:

> "We sincerely appreciate your calling this matter to our attention, and if further irregularities arise, please contact us."

This letter came to Schwanz' attention. Both Sheets and Schwanz testified that they regarded the closing paragraph at the time primarily as a formality and gave no particular thought at the time to what "further irregularities" might consist of. Sheets was undoubtedly aware at the time that an unreasonably long delay in delivery would be an "irregularity."

A number of things should be noted about this Dellwo incident. First it made the president and general counsel of MULIC aware that Dobich might be planning a concentrated sales effort in MULIC stock. Second, Sheets and Schwanz learned of a series of misrepresentations about MULIC being made by a salesman for Dobich Securities Corporation. Third, Sheets and Schwanz reacted to these misrepresentations with an immediate letter to the Indiana Securities Commission. Fourth, knowledge that MULIC had written the Indiana Securities Commission was of sufficient concern to Dobich to cause Dobich to visit the MULIC offices. And finally, both the MULIC officers and Dobich knew that MULIC's letter to the Securities Commission resulted in immediate attention.

During the period in question in this lawsuit, MULIC acted as its own transfer agent. Sometime on or shortly after August 10, 1964, MULIC received the first in what proved to be a long series of inquiries with regard to late delivery or nondelivery of MULIC shares purportedly sold by Dobich. This inquiry, dated August 10, came from Mr. and Mrs. Lucius M. Sheets and was directed generally to MULIC. The letter was received in the stock transfer department by Mrs. Margaret Grandstaff who was a supervisor in the stock transfer department. She called the

letter to the attention of Mr. Kent Wenbert, who until November of 1964 was employed by MULIC as head of the stock transfer department. The letter stated that Mr. and Mrs. Sheets (not to be confused with Ralph Sheets. MULIC's general counsel) had, on May 27, purchased 45 shares of MULIC stock from Dobich Securities Corporation, had paid for the shares, had been promised delivery in from four to six weeks, but had not as of August 10 received the certificate.

On August 11, 1964, Wenbert wrote a reply to Mr. and Mrs. Lucius Sheets in which he said that the shares had not yet been presented to MULIC for transfer and that Mr. and Mrs. Sheets might "check with the Indianapolis Board of Securities Dealers, if there is one." The shares were transferred to Mr. and Mrs. Sheets on the books of MULIC on August 21, 1964.

On August 21, Mrs. Mollie Frank called the MULIC offices to inquire about MULIC stock which she had purchased from Dobich, but which she had not received. Mrs. Grandstaff told Mrs. Frank that the certificate had not yet been received for transfer. Mrs. Grandstaff then learned that the certificate was in the process of transfer at that time. So she prepared a letter to Mrs. Frank over Wenbert's signature, informing Mrs. Frank that the certificate was being sent that day to Dobich. The transfer was in fact completed August 21.

On that same day, August 21, Miss Thelma Alberring wrote to MULIC, indicating that she had purchased some MULIC shares on May 5, but had not yet received them. The contents of this letter as mailed did not reveal either the name of the broker or the number of shares purchased.

On this letter, which was admitted into evidence as Plaintiff's Exhibit 13, there appears the language "110 shares from Dobich" in Wenbert's handwriting. Mrs. Grandstaff testified that she received two telephone calls with regard to this purchase, one from Miss Alberring and one from Miss Alberring's nephew. Mrs. Grandstaff learned from the nephew that the shares had been purchased from Dobich. For reasons that are not altogether clear, she assumed that the total number of shares purchased was 110, and she passed this information on to Mr. Wenbert. She also prepared a written reply to Miss Alberring which was sent over Wenbert's signature and which indicates that Miss Alberring was not yet a stockholder of record. On September 4, 1964, MULIC received a routine transfer letter from Dobich, and among the instructions in the letter was an instruction to issue 50 shares to Miss Alberring. The transfer was completed on September 14 without any inquiry into the difference between the 110 shares noted on Plaintiff's Exhibit 13 and the 50 shares in Dobich's instruction.

On September 24, 1964, MULIC received a letter from Phillip Irwin indicating that on August 13, 1964, he had purchased 645 shares of MULIC stock from Dobich Securities Corporation and that he had been told he would receive the certificate in three weeks. The letter indicated that Irwin had not yet received the stock. The letter came to Mrs. Grandstaff's attention, and she prepared for Mr. Wenbert's signature a reply indicating that the shares had not been presented to MULIC for transfer. MULIC received stock for transfer to Irwin on September 29 and also received on September 30 another letter from Irwin indicating that Dobich had told Irwin the stock was on its way. The transfer to Irwin was completed on October 1.

Sometime prior to September 28, 1964, Sheets, MULIC's general counsel, and Wenbert had a discusion in which Sheets was made aware of the complaints which were coming in about Dobich. Sheets also learned that with the exception of the Irwin purchase, the shares had ultimately been delivered. Sheets discussed the matter with Mr. Schwanz and, in particular, Sheets and Schwanz discussed the contents of a letter which Sheets proposed sending to Dobich. In particular, they discussed the possibility that Dobich might be using his customers' money as working capital. On September 28, 1964, Sheets wrote Dobich a letter, the contents of which are very significant. It read:

"Dear Mike:

"On quite a number of occasions during the past few weeks, we have received telephone or written inquiries from persons who advised that they have purchased and paid for Midwestern United Life Insurance Company stock through your company but have not yet received their stock certificates. Subsequently, you have forwarded stock to us with transfer instructions to the persons who had previously contacted us.

"Your purchasers who are subjected to such delays many times feel that the delays are caused by Midwestern United Life, and we are thus harmed by your delays. It appears that you are using your clients' money as working capital, which should not be done. If we receive any further inquiries from persons who allege that they have paid you for stock which they have not yet received and which we have not yet received for transfer, we will have to bring this matter to the attention of the Indiana Securities Commission.

"Mike, we do not want to cause you any trouble; but if, for some reason, your firm should be unable to make good on its obligations to transfer MULIC stock after your clients have paid for it, they might feel that MULIC is somehow responsible. We do not want this to happen.

"If there is some reasonable explanation for these delays, please let us know.

"Sincerely yours,
"Ralph E. Sheets"

It is clear from this letter that by September 28 Ralph Sheets had learned enough about Dobich's activities to conclude:

(1) that Dobich was using his customers' money as working capital;

(2) that this conduct was improper; and

(3) that this conduct was potentially harmful to MULIC.

Knowing all of these things, Sheets wrote Dobich a letter in which he stated that if MULIC received *any* further inquiries regarding lateness in delivery, MULIC would inform the Indiana Securities Commission. It is obvious that when Sheets wrote this letter he was fully aware of his previous contact with the Indiana Securities Commission in connection with the Dellwo matter. The Dellwo matter was Sheets' only previous contact with Dobich, and Sheets must have had it in mind or he would not have addressed Dobich as "Mike." Consequently, when Sheets told Dobich that he would report to the Indiana Securities Commission, he must have known that this

would cause Dobich at least as much concern as the Dellwo correspondence had caused Dobich.

True to expectation, Sheets' letter of September 28 brought an immediate response from Dobich. Dobich's reaction was the same as it had been in connection with the Dellwo matter—a desire for a personal meeting. On October 2, Dobich wrote Sheets:

> "Dear Ralph:
>
> "This writing is in response to your letter of September 28, 1964. We have developed a substantial interest in your company. I would like very much to have a brief meeting with you and Mr. Schwanz, if available, sometime soon.
>
> "I will phone you for a time that will be mutually agreeable to discuss your letter.
>
> "Yours truly,
> "Michael Dobich"

Schwanz and Sheets discussed this reply from Dobich. There can be no doubt from the record but that Schwanz got the message Dobich was trying to convey. He understood Dobich to be trying to persuade MULIC that Dobich was selling a lot of MULIC stock. It is extremely significant to note that this letter from Dobich came on the heels of a threat by MULIC to take action which might have put Dobich out of business. Thus, regardless of what attitude Sheets and Schwanz may have had toward Dobich, they knew that Dobich was trying to counter their threat with a representation that he, Dobich, was in a position to benefit MULIC.

On October 6, Claude Sheley, a MULIC agent, called Kent Wenbert and told Wenbert of a visit Sheley had just had with a Mr. Dennis Greenawalt at Greenawalt's store in Markle, Indiana. Sheley related that Greenawalt had purchased 100 shares of MULIC stock from Dobich the previous July, but had not yet received the certificate. Wenbert made a memorandum of Sheley's call, and by October 8 this memorandum had come to the attention of Sheets and Schwanz.

Following instructions from Schwanz, Sheets wrote another letter to Dobich, which Schwanz signed, relating the details of the Greenawalt inquiry and requesting that Dobich contact both Greenawalt and Schwanz. Coming as it did soon after Sheets' letter of September 28 and Dobich's reply of October 2, this letter clearly implied that Dobich had better come in soon with an explanation for his lateness in delivery or MULIC would do what Sheets had threatened in his letter of September 28.

A copy of this letter of October 8 to Dobich was retained in a file which was known as the "Michael Dobich File." This file was established in Mr. Sheets' office at the time of Sheets' letter to Dobich of September 28. It contained only those matters pertaining to Dobich which Sheets directly handled or of which Sheets received a copy. It did not contain all the materials which MULIC had concerning Dobich. These were not assembled until after Dobich died. There was no other specific file on Dobich within MULIC's offices prior to Dobich's death.

Shortly after Sheets sent his letter of October 8 to Dobich, Dobich telephoned Sheets and asked to see Sheets and Schwanz. A conference was arranged for October 12

at the general offices of MULIC in Fort Wayne, Indiana. The conference was held in Sheets' office. Schwanz was late in arriving for the meeting, but participated in most of it. Dobich was asked for an explanation for his lateness in delivery. Dobich explained that on some occasions he was having difficulty obtaining delivery from other brokers. The major explanation which Dobich gave was that he had been purchasing MULIC shares in large blocks and pledging them as collateral, and he was having difficulty getting the shares released once the loans were paid off with proceeds from sales. Both Sheets and Schwanz testified that they accepted this explanation. Schwanz asked Dobich whether he was "short" (that is, whether he was engaging in short sale transactions) and Dobich denied that he was short. Dobich then said that he was selling substantial amounts of MULIC stock. Schwanz said that did not matter, but he, Schwanz, wanted the practice of slow deliveries to be stopped. Although Schwanz testified that he believed Dobich's representation that he had large amounts of MULICH stock pledged as collateral, Schwanz also testified that he regarded as "salesmanship" and did not believe Dobich's statement that he was selling large amounts of MULIC stock. Dobich was asked how far behind he was in deliveries of MULIC stock, and Dobich said that in two weeks he could be completely caught up. An understanding was then reached that if MULIC were to receive further inquiries about late delivery after two weeks had expired from the date of the meeting, the inquiries were to be referred to the Indiana Securities Commission by MULIC.

It is not clear who first suggested the two-week period. The preponderance of the evidence is that Dobich stated that he could be caught up in two weeks, and Sheets and

Schwanz then insisted that he be caught up in two weeks or further inquiries would be referred to the Indiana Securities Commission.

The understanding which was reached at the October 12 meeting was confirmed in a letter dated October 13 from Sheets to Dobich. This letter read:

"Dear Mr. Dobich:

"This will confirm our understanding that within two weeks you will have caused Midwestern United Life Insurance stock to be transferred to any persons who have purchased such stock through or from you.

"If we receive information after two weeks from now that you are not making transfers to purchasers of MULIC stock within the normal time required of a broker to effect such transfers, we will have to refer future inquiries to the Indiana Securities investigation.

"Sincerely yours,
"Ralph E. Sheets"

Copies of this letter were sent to Schwanz, the president of MULIC, and to Kent Wenbert, head of the stock transfer department.

Certain things about the meeting of October 12 must be noted. At the meeting Dobich did two things of significance. First, he tried to explain his lateness in delivery of MULIC stock as legitimate, and, second, he reemphasized the statement in his letter to Sheets of October 2 that he was selling substantial amounts of MULIC stock.

In the months which elapsed between the Dellwo incident and October 12, the market price of MULIC stock rose substantially. Regardless of whether Sheets and Schwanz believed what Dobich said at the meeting of October 12, it must have been clear to Sheets and Schwanz that Dobich was trying to claim credit for the recent price increase. Schwanz plainly demonstrated his awareness of what Dobich was trying to do when he characterized Dobich's statements about selling MULIC stock as "salesmanship." In view of the fact, well known to all concerned, that the October 12 meeting resulted from a threat by MULIC to report what it knew to the Indiana Securities Commission, the inference is strong that it was clear to Sheets and Schwanz at the time of the meeting that Dobich was trying to convince MULIC not to precipitate another informal hearing by the Indiana Securities Commission. The inference is equally strong that Schwanz and Sheets knew that Dobich was trying to convince MULIC not to go to the Indiana Securities Commission regardless of whether they believed Dobich's explanation for his lateness in delivery.

Dobich did not get at the October 12 meeting all that he hoped for. Schwanz told him in plain language that regardless of how much MULIC stock Dobich was selling, Schwanz wanted delivery times to be normal. So an arrangement was worked out in which Dobich was to have two weeks to "get even with the board" or, in the words of Ralph Sheets, MULIC would "refer future inquiries to the Indiana Securities Commissioner for suitable investigation."

There is considerable conflict in the evidence as to whether at that point in time Sheets and Schwanz intended to refer future inquiries directly to the Commission or to tell

inquiring persons to go to the Commission themselves. As will be discussed later, they did not actually do either one. Up to this point Dobich knew only that in connection with the Dellwo matter MULIC had gone directly to the Commission and that on September 28 MULIC had threatened to go directly to the Commission again. Thus, when Sheets wrote on October 13 that MULIC would "refer future inquiries" to the Commission, it is highly probable that Dobich understood MULIC to be saying it would go directly to the Commission as it had done before. And regardless of what their actual intentions were, Schwanz and Sheets must have known that Dobich would take the letter to mean exactly what it said. Thus, after the October 12 meeting Dobich still viewed MULIC as a problem to be reckoned with, and MULIC knew that Dobich still viewed MULIC in that fashion.

The fact that Dobich was trying to prevent MULIC from doing anything which might precipitate an investigation was one indication that Dobich's "explanation" for his late deliveries was spurious. Sheets and Schwanz should have been particularly on their guard against such false explanations in view of their expressed suspicion that Dobich was using his customers' money as working capital. The primary explanation which Dobich gave, that he was having difficulty securing the release of shares pledged as collateral, was hardly a persuasive one in view of what Schwanz and Sheets, as experienced businessmen, knew about such business practices. Moreover, if Schwanz and Sheets completely accepted Dobich's explanation, it is difficult to understand why they would warn him nevertheless that they would report him to the Securities Commission if his lateness in delivery continued. Despite their testi-

mony that they accepted Dobich's explanation, the preponderance of the evidence produces the inescapable inference that Sheets and Schwanz still believed after the meeting that Dobich was "short," but hoped that in two weeks Dobich could be caught up.

If Sheets had any thought that Dobich might have been telling the truth at the October 12 meeting about his lateness in delivery, that thought was dispelled by two memoranda which came to Sheets from Kent Wenbert on October 15. One of these related a visit which Beryl J. Grose made to Wenbert. Grose told Wenbert that he had purchased 119 shares of MULIC stock from Dobich on July 3 and another 40 shares on July 7, but had not yet received his stock despite two letters to Dobich. Grose told Wenbert that Dobich had said delivery would be delayed because Dobich did not want to "flood the market" with MULIC stock. All this information was in the memorandum from Wenbert to Sheets. The memorandum also indicated that Wenbert advised Grose to contact the Securities Commission in Indianapolis. The other memorandum related that A. M. Buscher had telephoned Wenbert. Buscher told Wenbert that he had purchased 50 shares of MULIC stock from Dobich on August 24, but had not yet received the stock. Buscher told Wenbert that the Dobich representative had said that "the stock was in inventory and any delay in its delivery would be the fault of Midwestern United Life." Sheets knew that the explanations for late delivery given to Grose and Buscher were contrary to the explanation Dobich had given the MULIC officers, Sheets and Schwanz. Sheets also knew that the explanation given Grose was absurd, and the explanation given Buscher was both false and harmful to MULIC.

Sheets testified that after reading these memoranda he still accepted Dobich's explanation about slow delivery which Dobich gave at the October 12 meeting, but ". . . I probably assumed that this was the easy [sic] for him to put the blame on us rather than to go through the intricacies of explaining his financial situation. . . ." From the evidence it is difficult to conclude that Sheets would have permitted Dobich to use a false explanation which harmed MULIC if Sheets thought that Dobich had a legitimate explanation which he could have used instead. It is more reasonable to conclude that Sheets knew Dobich was offering any explanation for slow delivery, however false, which he thought might be accepted. A reasonable conclusion is that Sheets knew that Dobich was actually using his customers' money for his own purposes, but nevertheless saw fit to go through with the "two week" bargain which he and Schwanz had made with Dobich three days before.

The same day as Wenbert's two memoranda to Sheets, October 15, MULIC received yet another inquiry about slow delivery, this one from George Puetz. Mr. Puetz related that he had placed three different orders for stock in MULIC, the first of which was on June 11, but that he had not received any stock. The letter from Puetz made no mention whatsoever of Dobich, nor did it in any other manner identify the broker. The letter came to the attention of Mrs. Grandstaff, who consulted with Wenbert. She and Wenbert together wrote a reply, dated October 15, 1964, in which Puetz was informed that the stock had not been presented for transfer, and it was suggested that Puetz "contact the broker through whom these purchases were made." The reply mentions neither Dobich nor the Indiana Securities Commission. Blind carbon copies (which

are copies sent without so indicating on the face of the original) of the reply were sent to Ralph Sheets and to Michael Dobich. No one, including Mrs. Grandstaff, Mr. Wenbert, Mr. Sheets, or Mr. Schwanz, could explain how it was determined that the stock had been purchased from Dobich, although Mrs. Grandstaff testified that she would not have sent Dobich a blind carbon without knowing somehow that Puetz had bought the shares from Dobich. One thing about this correspondence is clear. Whoever made the decision to send Dobich a blind carbon copy of the MULIC reply to Puetz, whether it was Sheets, Wenbert, or Mrs. Grandstaff, knew enough about the pattern of complaints regarding slow delivery to know that they were chiefly, if not exclusively, about Dobich. MULIC's failure to refer the Puetz inquiry to the Indiana Securities Commission was consistent with the understanding which had been reached in the meeting with Dobich three days before, and for that reason MULIC's notification of Dobich by way of a blind carbon copy in no way indicated to Dobich anything significant about the manner in which MULIC might handle inquiries coming in later.

On October 22, 1964, Mr. Schwanz received a telephone call from Orville Krieger, a broker who had in the past initiated some contacts with MULIC which had resulted in purchases of various businesses by companies associated with MULIC. In this telephone call Krieger informed Schwanz that the Illinois Mid-Continent Life Insurance Company of Chicago might be interested in a merger with MULIC. Negotiations were opened with certain officials of Illinois Mid-Continent (hereinafter referred to as IMC), and by October 28 a preliminary agreement had been reached, on the terms of a proposed merger between

MULIC and IMC. The merger was to be consummated on the basis of an exchange by IMC shareholders of ten shares of IMC stock for each share of MULIC stock. An agreement of merger was signed on November 5, based upon this ten-to-one ratio. On November 10, three dissident directors of IMC filed suit in the Circuit Court of Cook County, Illinois, to enjoin consummation of the merger. An extended proxy fight followed which culminated in a vote of IMC shareholders on February 4, 1965. The required two-thirds of IMC shareholders did not vote in favor of the merger, and the merger consequently was not consummated. Schwanz denied that the ten-to-one ratio of exchange of IMC shares for MULIC shares was based primarily on the market prices of the two stocks prevailing at that time. However, the preponderance of the evidence is clearly that this ratio was based primarily, if not exclusively, on prevailing market prices. During the fourth quarter of 1964, the approximate bid price of MULIC stock ranged from a bid prices for IMC stock ranged from a low of 7½ to a low of 80½ to a high of 93. During this same period the high of 11¼. Schwanz testified that to his best recollection the price of MULIC during the IMC merger negotiations was in the "upper 80's" while IMC was selling at "between seven and eight." The bid and asked prices for the two stocks as reported in the Wall Street Journal were discussed during the negotiations. A letter sent to the shareholders of IMC on December 3, 1964 by the IMC directors who supported the merger emphasized the market prices of the two stocks, but did not mention book values at all. A similar letter sent on January 5, 1965 contained an underlined statement that "at current market prices the 10 for 1 exchange ratio is distinctly favorable to you and

other holders of Illinois Mid-Continent." This letter also made no mention of book values. Sometime in December of 1964, Schwanz telephoned Theodore P. Beasley, Chief Executive Officer of the Republic National Life Insurance Company of Dallas. Schwanz gave Beasley some market quotations for MULIC and IMC stock and asked his opinion on the fairness of the merger. Schwanz received from Beasley a letter of opinion that, based upon the market quotations furnished by Schwanz, the merger terms were fair. In contrast to the ratio of approximately ten to one in market prices which prevailed during this period, the ratio of adjusted book values as of September 30, 1964 was approximately four to one or five to one, depending upon the formula applied. No meaningful basis for the ten-to-one merger ratio other than market value was suggested by the evidence. It is clear that consummation of a merger with IMC based upon the then prevailing market prices would have increased the post-merger book value of MULIC shares.

The ten-to-one ratio of exchange, which was the basis of the proposed IMC merger, depended upon the price of MULIC shares remaining in the upper 80's and low 90's during the negotiations and subsequent proxy fight. MULIC stock had only very recently achieved this price level. The price increase had put MULIC in a much more favorable position for mergers, and the prospects for successful consummation of the proposed IMC merger depended upon having nothing happen which would drive the price of MULIC stock sharply or suddenly down. By November 10 MULIC knew that a proxy fight was developing among the shareholders of IMC. Public disclosure of Dobich's activities and of MULIC's knowledge of those

activities would have been extremely embarrassing. Therefore, any change in MULIC's attitude toward Dobich after the beginning of negotiations for merger with IMC must be viewed realistically and in light of all the other circumstances then known. It must have been obvious to the president and general counsel of MULIC that stability of the price of MULIC stock at its recently attained level was an objective worth pursuing. Again the inescapable inference is that these men viewed Dobich's sales activities as a benefit to MULIC, and they elected to pursue this benefit.

There is abundant evidence that a very pronounced change in MULIC's attitude toward Dobich did in fact take place sometime between October 13 and November 30, 1964. This change in attitude was first disclosed *to Dobich* in connection with an inquiry from Robert Dillon. On or about November 23, 1964, MULIC sales agents Fred Johnson and Ralph Matthews called upon Dillon. Dillon told them that he had traded 1,549 shares of First United Life Insurance Company stock to Dobich in exchange for 200 shares of MULIC on September 10, 1964, but he had not yet received his MULIC shares.

Johnson called Schwanz from Dillon's office on November 23 and related to him the details of Dillon's purchase. On November 30, 1964, Sheets wrote Dobich as follows:

"Dear Mr. Dobich:

"We have been contacted by Mr. Robert E. Dillon, who advises that he purchased 200 shares of Midwestern United Life Insurance Company stock from you on September 10, 1964, at $82.00 per share and traded in 1,549 shares of First United Stock at $10.50. He advises that to date he has not received his MULIC stock.

"We are suggesting to Mr. Dillon that, in the event he does not receive his stock immediately or does not receive a satisfactory explanation for the delay, he turn the matter over to his personal attorney and/or contact the Indiana Securities Commissioner.

"I hope it will not be necessary for him to take this action.

"Sincerely yours,
"Ralph E. Sheets"

Sheets sent a carbon copy of this letter to Dillon, along with another letter advising Dillon to consult an attorney or the Securities Commissioner *if* he did not hear from Dobich "right away." Sheets gave Dillon the name and address of the Securities Commissioner.

At the trial, Sheets was asked why he did not write to the Commissioner directly as had been done in the Dellwo matter. Sheets testified that it was his and Schwanz' intention to refer "inquiring persons" to the Commission and his use of the word "inquiries" in his letter of October 13 to Dobich was inadvertent and should have been "individuals making inquiries." But the fact of the matter is that Sheets did not do either one. He referred Dillon to Dobich, and only secondarily to the Commission *in the event that Dobich did not then deliver.*

The significance of Sheets' letter to Dobich on November 30 is far greater than that it gave Dobich an opportunity to deliver to Dillon and keep Dillon away from the Securities Commission. It must be remembered that until this time, Dobich had no reason to think that if a complaint about late delivery came to MULIC, MULIC would do anything less serious (from Dobich's point of view) than forward the inquiry directly to the Indiana Securities Commission. It is reasonable to conclude that Dobich, until

this time, had good cause to fear that MULIC might even take its whole history of complaints to the Commission. Dobich had tried at the October 12 meeting to convince Schwanz and Sheets that he was worth protecting, but u until November 30 Dobich had no reason to suspect that his efforts had been successful. So it must have come as an extremely pleasant surprise to Dobich to learn that so lon as he delivered Dillon's shares, MULIC would keep sti Nowhere in his letter did Sheets suggest that Dobich was appropriating his customers' money or that his conduct was improper or that Dobich was giving MULIC a bad name. In short, all the expressions of generalized concern about Dobich's activities, so evident in the letters of September 28 and October 13 and in the meeting of October 12, were gone. In their place was a letter indicating that so long as the *particular* complaint was satisfied, MULIC had no further concern.

As previously noted, the irresistible conclusion is that Sheets knew well before November 30 that Dobich's explanation about slow delivery was not truthful. As an intelligent and responsible businessman, he must have realized that there were others who had purchased shares from Dobich without getting delivery besides those who had complained to MULIC. And yet Sheets wrote Dobich a letter which, as Sheets well knew, fell far short of what MULIC had threatened to do in all its previous contacts with Dobich. Sheets must have known that Dobich would regard the letter as a substantial change in MULIC's position, a change that would enable Dobich to stay in business so long as he satisfied the complaints which came to MULIC. Dobich no longer had to "get even with the board" or risk being reported by MULIC. The change in MULIC's attitude which MULIC first made known to Do-

bich in Sheets' letter of November 30 was therefore a substantial and knowing encouragement to Dobich to continue his activities without fear of a report from MULIC to the Indiana Securities Commission.

From November 30 until Dobich's death in July of 1965, MULIC uniformly maintained the attitude, first made known to Dobich in the letter of November 30, that so long as the particular complaint coming to MULIC was satisfied, MULIC had no further concern. It did not take long for this new attitude to reflect itself in the stock transfer department. On December 1, 1964, a postcard addressed to Mr. Schwanz from Frederic E. Volkee arrived at the MULIC offices. Schwanz was in Chicago, so the card was referred to the stock transfer department, where it came to Mrs. Grandstaff's attention. The card related that Volkee had purchased MULIC stock from Dobich "many months ago" but had not received it. Mrs. Grandstaff discussed the matter with the new head of the stock transfer department, Max A. Roesler. She then sent a letter to Volkee over Roesler's signature, informing Volkee that the stock had not been received for transfer. The letter suggested that Volkee contact Dobich, and *if that did not help*, Volkee should contact his attorney or the Indiana Securities Commission. The letter then gave the address of the Indiana Securities Commission. It is interesting to note that the suggestions made in this letter were identical to those made in Sheets' letter to Dillon of the previous day. Both Sheets and Mrs. Grandstaff testified that the Volkee matter did not come to Sheets' attention at all.

Mrs. Grandstaff sent to Dobich a *blind carbon copy* of her letter to Volkee. She testified that she sent the blind carbon on her own initiative, although she was not sure

why she did it. In response to a question from the Court, she testified that her procedure to send blind carbons of such letters to Dobich might have been precipitated by the meeting between Dobich, Sheets, and Schwanz on October 12. However, she also testified that at the time she first sent a blind carbon copy of such a letter to Dobich, on the occasion of the October 15 letter to George Puetz, she did not know of the October meeting. How blind carbon copies of such letters came to be sent to Dobich remains an unexplained mystery.

Whoever sent to Dobich the blind carbon copy of the letter to Volkee, it is clear that the copy performed exactly the same function as Sheets' letter to Dobich of the day before. It disclosed to Dobich that Volkee was being advised in exactly the same manner as Dillon had been advised. Moreover, Dobich could scarcely have failed to notice that the problem of late deliveries was no longer a matter for treatment by the highest officers of MULIC, but, rather, since a policy had been established, such matters were now being handled by the stock transfer department. So far as Dobich knew, the matter never ventured higher than the stock transfer department again. Sheets' letter of November 30 was the last direct communication Dobich received from either Sheets or Schwanz.

The communications of November 30 and December 1, 1964, from MULIC to Dobich constituted a substantial encouragement and assistance to Dobich in that they:

(1) indicated to Dobich that MULIC no longer intended to do what it had previously threatened to do, namely, report Dobich's conduct to the Indiana Securities Commission and

(2) indicated to Dobich that thenceforth MULIC would follow a procedure of referring inquiries to Dobich, thereby giving Dobich an opportunity to satisfy the complain and thus prevent his customer from reporting to the Commission.

From November 30 until Dobich's death, Dobich did not receive one communication from MULIC which might have caused him to change his estimate of what MULIC was likely to do. Throughout the first half of 1965, until Dobich died, MULIC continued to take the view that so long as particular complaints which came to MULIC were satisfied, Dobich could be left alone. And with this assurance that MULIC was now going to help him rather than report him Dobich continued to assume that so long as particular complaints which came to MULIC were satisfied, Dobich and his organization would be left undisturbed. And with this assurance, Dobich continued his fraudulent practices unabated.

On February 11, 1965, Schwanz received a letter from Charles Kankamp, a MULIC shareholder, indicating tha George Anstett, James Hanna, Kenneth Hanna and Bill Hanna had purchased shares of MULIC from Dobich in mid-October 1964. The letter indicated that Kenneth and Bill Hanna had received their stock after a further inquiry directed to the Dobich salesman, but George Anstett and James Hanna had not received theirs. This letter came to the attention of both Schwanz and Sheets, but neither did anything about it except to refer it to Mrs. Grandstaff. Mrs. Grandstaff learned that James Hanna's shares had been transferred February 5. She called George Anstett and told him to call Dobich. She cannot recall whether she mentioned the Indiana Securities Commissioner. Anstett's stock was transferred on February 24.

On February 16, 1965, a MULIC agent, Robert Funk, called upon Schwanz' secretary, Miss R. A. Didier, and told her that a Mr. and Mrs. James Conrad of Waterloo had received it just during the past two weeks. The Conrads purchased 54 more shares in November, and Miss Didier learned from Mrs. Grandstaff that these shares had just been transferred February 15. Miss Didier put this information in a memorandum to Schwanz, who saw it but took no action because the memorandum indicated the shares had been delivered.

On March 8, 1965, J. H. Goddard & Co., Inc., a brokerage firm, sent telegrams to a large number of MULIC shareholders, recommending exchange of MULIC shares for those of another insurance company. Shortly thereafter, Schwanz learned of a number of these telegrams and, on March 12, Schwanz sent a letter to all MULIC's shareholders reviewing the year's progress and urging retention of MULIC shares. Plaintiff's Exhibit 39 discloses that the price of MULIC stock fell from a level of 90 bid, 92 asked on March 5 down to 79 bid, 82 asked on March 12. The price then rose somewhat to 83 bid, 86 asked on March 19 and then fell again to 72.4 bid, 74.4 asked on March 26.

Two days after the Goddard telegrams went out, on March 10, 1965, MULIC began serious negotiations for a merger with Great Northern Life Insurance Company. The merger which was ultimately negotiated with Great Northern was more closely related to the relative book values of the two companies than the IMC merger had been, although the relative market prices of the two stocks were taken into consideration. The merger was delayed somewhat in May or June of 1965 by the efforts of one George Snyder to collect a "finder's fee." The merger was finally consummated on July 26, 1965.

These events occurring in the early part of 1965 reveal a continuation of the attitude of MULIC officials toward Dobich which first became evident during the negotiations and proxy fight in relation to the proposed merger with IMC. Schwanz' reaction to the Conrad inquiry reveals that Schwanz no longer felt a need to take any action so long as the inquiry revealed that the shares had ultimately been delivered. Even if the shares had not to Schwanz' knowledge been delivered, Schwanz was content to let the stock transfer department handle it, as his treatment of the Kankamp inquiry shows. Schwanz' immediate reaction to the Goddard telegrams and the opening of negotiations for merger with Great Northern reveal that Schwanz was no less sensitive about the price of MULIC stock in the spring of 1965 than he had been in the fall of 1964. Exposure of Dobich's activities would have been no less embarrassing in the winter and spring of 1965 than in the fall of 1964.

Although further complaints of lateness in delivery continued to come to Schwanz, to Sheets, and to the stock transfer department, MULIC uniformly followed the practice of advising inquiring persons to contact Dobich *before* contacting the Securities Commission.

On April 8, 1965, Beryl Grose, who had made one complaint to MULIC the previous October 15, wrote to MULIC and indicated that he had purchased 63 additional shares of MULIC stock from Dobich on March 4 and he was concerned about the 10% stock dividend which MULIC had declared for stockholders of record as of March 31, 1965. Mr. Roesler of the stock transfer department replied that the shares had not been received for transfer and payment of the dividend was therefore the broker's responsibility.

On April 12, 1965, Margaret E. Schriefer wrote to MULIC and stated that she had purchased ten shares of MULIC from Dobich the previous October, but had not yet received the certificate. Roesler wrote back on April 14 and said that the ten shares had not been received for transfer. The letter suggested that Mrs. Schriefer contact Dobich. Neither this letter nor Roesler's letter to Grose mentioned the Indiana Securities Commissioner. Neither exchange of letters came to the attention of Ralph Sheets. No instructions had been left with either Kent Wenbert or Max Roesler following the October 12 meeting with Dobich to call further complaints about Dobich to the attention of Sheets or Schwanz.

Sometime around April 14, Dennis Greenawalt, who had already complained about Dobich once the previous October 6, called Schwanz and said that he had purchased 50 additional shares of MULIC from Dobich on October 27, 1964, but he had not received the certificate. Schwanz passed the information along to Sheets, who wrote Greenawalt on April 14. Sheets informed Greenawalt that the additional 50 shares had not been received for transfer and suggested that Greenawalt contact Dobich and threaten to contact the Securities Commissioner *if he didn't receive the stock.* Sheets also gave Greenawalt the name and address of the Securities Commissioner. Neither Sheets nor Schwanz could explain why they advised Greenawalt to contact Dobich first, rather than having MULIC or Greenawalt contact the Commission directly, except to say that they thought this action would be sufficient to get Greenawalt his stock.

In April and May of 1965, MULIC received a series of letters from alleged purchasers of MULIC stock from Dobich which indicated that Dobich was still extremely slow in making deliveries. Briefly summarized, these letters included a letter dated April 21 from Dr. Richard S. Johns of Munster, Indiana, indicating a purchase of 90 shares of MULIC stock in August, 1964, for which delivery was finally accomplished with difficulty on March 31, 1965; a letter dated April 19 from Paul Hirsch, an attorney representing Dorothy Jane Martin and Verlyn Jay Martin, indicating a purchase of 110 shares on December 14, 1964, for which delivery was finally accomplished on April 23, 1965; a letter dated April 19 from Myron A. Phillips of Plymouth, Indiana, indicating a purchase of 16 shares on December 13, 1964, for which delivery was finally accomplished on May 12, 1965; a letter of May 3, 1965 from Galen Bowman indicating a purchase of ten shares on February 4, 1965, for which delivery was finally accomplished on May 12, 1965; a letter dated May 5, 1965 from Mrs. Stephen Kalabany of South Bend, Indiana, indicating a purchase of 100 shares no later than the end of 1964 for which delivery was accomplished May 12, 1965; and a letter dated May 10 from Donald F. Crane of Loogootee, Indiana, indicating a purchase of MULIC stock from Dobich sometime before March 31, 1965 for which delivery was finally accomplished in June 1965. All of these letters were received and answered by Max Roesler in the stock transfer department. There is no evidence that any of them came to the direct attention of anyone at MULIC outside the stock transfer department.

Sometime in early May 1965, James Frank, an attorney in Union City, Indiana, telephoned Ralph Sheets, MULIC's general counsel, and said that his mother, Mrs. Mollie

Frank (the same Mollie Frank who had telephoned the MULIC offices the previous August 21) had purchased some additional shares of MULIC stock from Dobich but had not received the certificate. Sheets advised Frank to contact Dobich and *if Dobich didn't deliver*, to contact the Indiana Securities Commission. In a letter of May 10, Sheets again advised Frank to contact Dobich. The letter did not mention the Securities Commission. Frank went to Dobich's office, where Dobich instructed one of his employees to call MULIC and have them transfer additional shares to Mrs. Frank. Twenty shares of MULIC stock were transferred to Mrs. Frank on May 12.

On May 17, Dudley Campbell of Rushville, Indiana, wrote to Donald Grissom, first vice president, secretary, and a director of MULIC. He informed Grissom that he had purchased 123 shares of MULIC stock from Dobich on March 10 and another 100 shares of [*sic*] March 15, but he had not yet received the certificates. He told Grissom that Dobich had said MULIC's transfer department was slow. On May 19, Grissom replied to Campbell, telling him that the certificates had been mailed to Dobich on May 17.

The only other direct contact which Grissom had with the Dobich complaints came on May 20. On that date, Grissom received a telephone call from Frederick R. Postlethwaite, a stock broker in Indianapolis. Postlethwaite informed Grissom that one Ronald Mercer had purchased 100 shares of MULIC stock from Dobich some months previously but had not yet received the certificate. Postlethwaite put this information into a letter to Grissom dated May 24. Grissom discussed the matter with Sheets, who told Grissom that there had been other complaints of slow delivery about Dobich. Grissom told Postlethwaite to advise Mercer that Mercer should contact Dobich and/or

report the nondelivery to the Securities Commission. Grissom later learned that the transfer to Mercer had been completed on June 4.

Early in June of 1965, MULIC life insurance sales agents Browne Gilbert and Fred Johnson called on William Richter at his office in Indianapolis. Richter told the agents that he still had not received the 40 shares of MULIC stock which he had purchased from Dobich in November. Gilbert and Johnson offered to call MULIC officials about it, and Johnson actually spoke to Schwanz about it. Gilbert then sent a copy of Richter's purchase order, Dobich's letter of acknowledgment, and Richter's canceled check to Schwanz. The letter of acknowledgment which Gilbert sent to Schwanz was typical of those Dobich sent to his customers after October 23, 1964. It contained the representation that Dobich was "creating a heavy interest" in MULIC stock, and it clearly stated that delivery would be "later than usual." Schwanz referred the matter to Sheets, and at that time the two discussed the possibility of consulting the Indiana Securities Commission. They did not do so, however. Instead, Sheets wrote a letter to Gilbert in which he told Gilbert to advise Richter to consult Dobich. Sheets told Gilbert to advise Richter that Richter should tell Dobich he would consult the Indiana Securities Commission and the United States Securities and Exchange Commission *if he did not receive immediate delivery.* Sheets testified that he did not then know that the Securities and Exchange Commission had jurisdiction over such matters. He considered mention of the Securities and Exchange Commission as another "pressure tactic" to use against Dobich. Gilbert advised Richter along the lines that Sheets had suggested.

On June 17, 1965, MULIC received a letter from W. Harry Bonifield of Warren, Indiana, informing MULIC that Bonifield had purchased 20 shares of MULIC stock from Dobich in January but had not yet received it. The letter came to the attention of Ralph Sheets who wrote a reply on June 21. Sheets informed Bonifield that the stock had not been received for transfer. The letter informed Bonifield that he would have to obtain the stock dividend of March 31, 1965 from Dobich. The letter did not otherwise make any suggestion as to how Bonifield should proceed in getting his stock. The Indiana Securities Commission was not mentioned.

Sometime in June 1965, Robert Funk, a MULIC sales agent, told Mrs. Grandstaff that Leland Miller of Spencerville, Indiana, had sometime previously purchased MULIC stock from Dobich but had not received it. Funk requested that Mrs. Grandstaff check on it, write to Miller, and notify Dobich. On June 28, Mrs. Grandstaff wrote a letter over Max Roesler's signature, telling Miller that his shares had not been received for transfer. The letter suggested that Miller contact Dobich. It did not mention the Indiana Securities Commission. The letter indicated on its face that a carbon was sent to Dobich. Why Mrs. Grandstaff sent an open carbon copy in this case, whereas she sent blind carbon copies to Dobich in two previous cases, has not been satisfactorily explained.

On June 29, 1965, Mrs. Frank Gladden of Indianapolis called the MULIC offices and spoke to Ralph Sheets. She told him that in December of 1964 she and her husband had purchased stock in MULIC from Dobich, but that despite repeated requests to Dobich they had not received it. Sheets told her that MULIC had received a number of

previous calls like hers, but that MULIC could do nothing about it. She was advised to *call Dobich* and "threaten to prosecute."

On July 8, 1965, Schwanz received a letter from Mrs. Evelyn Carson of Logansport, Indiana. Mrs. Carson informed Schwanz that she had purchased 63 shares of MULIC stock from Dobich in February and March of 1965, but that despite repeated efforts she had not received the certificates. The letter also informed Schwanz about an aunt of Mrs. Carson who was in a similar position. Schwanz instructed his secretary to have Ralph Sheets write a reply to Mrs. Carson and a letter to the Indiana Securities Commissioner. Schwanz' secretary took the Carson letter and these instructions to Sheets' secretary, Janice Vice (now Mrs. Janice Drake). Miss Vice then prepared a rough draft of a letter to Mrs. Carson and a rough draft of a letter to the Indiana Securities Commissioner, and placed these drafts, together with the Carson letter, on Sheets' desk. Sheets found these on his desk late in the afternoon of Friday, July 9. Sheets was planning to go to Indianapolis on Monday, July 12, in connection with the proposed merger with Great Northern Life Insurance Company. He testified that he planned to visit the office of the Securities Commissioner on Monday with the Carson letter and so he destroyed the two drafted letters which Miss Vice had prepared. In any event neither of them was ever mailed.

Dobich was killed the next day, Saturday, July 10. Sheets went to Indianapolis on Monday, July 12. He learned of Dobich's death sometime that day. He testified that he did not visit the Securities Commissioner on Monday because his work on the Great Northern merger occupied all his time.

After Dobich died, a number of additional complaints about nondelivery of MULIC shares purchased from Dobich came to the attention of both sheets and Schwanz. One such complaint came in a telephone call from F. Robert Jennings, an Indianapolis businessman, to Schwanz on July 13, 1965. Jennings told Schwanz that he had purchased 30 shares of MULIC stock from Dobich on April 1, but that he never received the stock. Schwanz and Jennings differ as to what happened next. According to Jennings, Schwanz then said that he had considered "shutting [Dobich] off" but that he did not because he was afraid people might lose money. According to Jennings, Schwanz also said that it was unfortunate Dobich died because if he had lived he "might have pulled it off."

Schwanz and Sheets knew well before November 30, 1964 that Dobich was dealing in a fraudulent manner with his customers' money. Nevertheless, it is apparent that the MULIC organization consistently followed the practice of referring inquiring Dobich customers *first* to Dobich before referring them to the Indiana Securities Commission. Schwanz acknowledged that in each instance of a complaint, the inquirer was referred first to Dobich. Moreover, Schwanz conceded in his oral testimony that referring an inquiring person to Dobich, and only after that to the Indiana Securities Commission, had the effect of giving Dobich an opportunity to make delivery and thus prevent the matter from reaching the Commission.

The Court recognizes that, as will be discussed, the Indiana Securities Commission received complaints about Dobich Securities Corporation regarding slow delivery. These complaints were similar to those which might have been written to the Commission had MULIC not followed the

practice outlined above. The significance of MULIC's practice was *not* that it prevented Dobich customers from complaining to the Indiana Securities Commission. The significance of MULIC's practice was that it indicated *to Dobich* that MULIC would not, as it had previously threatened, *itself* report Dobich's activities. In addition, MULIC's practice indicated to Dobich that MULIC would assist him in identifying the customers most concerned and most likely to complain to the Commission. This second indication from MULIC also encouraged Dobich because Dobich had no way of knowing that other complaints about slow delivery were actually reaching the Commission.

The evidence as a whole fails to support the defendant's contention that all of its activities in relation to Dobich were solely for the purpose of assisting Dobich customers to get their stock. So far as MULIC knew, a report from MULIC to the Indiana Securities Commission would have been at least as effective in accomplishing MULIC's stated purpose as the method which MULIC actually selected. And before MULIC learned that Dobich's activities would benefit MULIC, MULIC had threatened to make such a report to the Commission. It is highly significant, therefore, that *after* MULIC had learned more about Dobich's activities, MULIC chose to follow a practice which, while consistent with the stated purpose of compelling Dobich to satisfy the complaints, was nevertheless much less likely to result in curtailment of Dobich's activities than a report to the Commission would have been. Moreover, if Schwanz and Sheets were as concerned about compelling Dobich to make deliveries within normal times as they claimed at trial, it is difficult to explain why neither of them ever instructed the stock transfer department to call future inquiries about slow delivery to their attention.

The defendant has argued that because most of the complaints about late delivery were ultimately satisfied, Dobich's activities were not a matter of serious concern, but the evidence discloses that this argument has no merit. The occurrences of slow delivery were clearly matters of great concern to Ralph Sheets when he wrote Dobich on September 28, 1964 that Dobich customers "might feel that MULIC is somehow responsible." At the time Sheets wrote that letter, he knew that shares had been delivered to three out of the four people who had complained, yet he viewed Dobich's practice of late delivery as a matter of great concern to MULIC. Certainly Sheets and Schwanz would not have required Dobich to explain his methods at a meeting on October 12 if they had not seen in those methods some cause for concern. Moreover, neither Sheets nor Schwanz made a practice of following up inquiries to see if the stock was delivered. It is clear, therefore, that Sheets and Schwanz saw no great distinction between unreasonably slow delivery and complete nondelivery. Both practices constituted "irregularities" to them.

Throughout the period of Dobich's activities, both Sheets and Schwanz knew that the Indiana Securities Commission had the power to revoke the license of a dealer such as Dobich. As a result of the Dellwo matter, Sheets and Schwanz had also been made aware of the Commission's attitude in regard to irregularities reported by the corporation whose stock was the subject of such irregularities.

During the period of Dobich's efforts in the market in relation to MULIC stock, the market price of MULIC stock first rose substantially and then fell substantially. In the spring and early summer of 1964, the bid and asked prices fluctuated in the upper 60's and low 70's. In the summer

and early fall the price began a steady increase. By the week of the meeting among Dobich, Sheets and Schwanz, October 12, 1964, the price had risen to 84 bid, 88.4 asked. By October 23, 1964, which is approximately when negotiations for the Illinois Mid-Continent merger began, the price had risen to 87 bid, 91.4 asked. The price reached a peak in late December 1964 of 93 bid, 97.4 asked. The price remained around 90 until about the time the Goddard telegrams were sent on March 8, 1965. The price dropped sharply during the week of March 12, and after a brief comeback it continued to decline throughout the spring and summer of 1965. On July 9, 1965, the day before Dobich died, the price was 66.4 bid; 68.4 asked. These prices are adjusted to reflect the 10% stock dividend effective March 31, 1965.

The greater weight of the evidence clearly indicates that Dobich's activities actually influenced the price of MULIC stock. It is of equal if not greater importance that MULIC's highest ranking officials *believed* that Dobich's activities were affecting the market for MULIC shares. Both Sheets and Schwanz were well aware of the price movements of MULIC stock. Schwanz understood the workings of the over-the-counter market for securities, and he knew as a result of the Dellwo matter that Dobich liked to "work one stock at a time." By October of 1964, Schwanz knew enough of Dobich's activities to know that he was "working" MULIC stock. By October, Schwanz suspected that Dobich was engaging in short sales, and he knew that an effort to "cover" short sales by purchases would result in upward pressure on the market price. Schwanz was acutely sensitive to MULIC's market price during the negotiations for merger with Illinois Mid-Continent, a pro-

posed merger which was based primarily upon relative market prices and which depended for its success upon maintenance of MULIC's market price at a level which it had only very recently attained.

For reasons which have been discussed here and elsewhere in this opinion, it is clear that MULIC's change in attitude toward Dobich Securities Corporation was for the purpose of preserving a high and stable market price for MULIC stock in order to gain certain advantages for MULIC.

This long and detailed account of MULIC's activities as they related to Dobich Securities Corporation has been necessary because only from an assimilation of a large number of small incidents can ultimate conclusions about MULIC's knowledge and conduct be derived. The unusual facets of this case will be observed in the unique facts and surrounding circumstances which have been disclosed by the evidence and not in any unusual application of legal principles. It is for this reason that an unusually long and detailed statement of facts has been required. No one incident or witness has provided a complete picture of the relevant facts and circumstances. An accurate understanding of MULIC's knowledge and conduct can be derived only from a chain of factors disclosed by many witnesses, exhibits, and stipulations. This case clearly demonstrates that the limits of duties prescribed by the Securities Exchange Act of 1934.

> ". . . cannot be confined to an abstract rule but must be fashioned case by case as particular facts dictate." *Kohler* v. *Kohler Co.*, 319 F.2d 634, at 637-638 (7th Cir. 1963).

In *Hawkins* v. *Merrill, Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark. 1949), a case which resembles

the instant case in some respects, the plaintiffs had purchased stock from a broker-dealer, D. S. Waddy, who never delivered the shares. Waddy maintained an account with the defendant brokerage firm through which he accomplished his fraudulent transactions. After discovery of the fraud, the plaintiffs sued the brokerage firm, alleging a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission. The court held that the plaintiffs were entitled to recover. The court found that the defendant knew some of the details of Waddy's fraudulent conduct, but nevertheless permitted him to use his account with it without adequate supervision. The court also found that certain conduct of the defendant had helped prevent the Securities and Exchange Commission from discovering Waddy's fraudulent activities. While the facts of the instant case differ from those of *Hawkins,* the principle remains that certain conduct of MULIC encouraged Dobich's fraud and helped him conceal it. This conduct by MULIC constituted a "disregard [for] the rights of the public secured by the Securities Exchange Act of 1934." *Hawkins, supra,* 85 F. Supp. at 122.

There is no need to prolong this opinion by repeating the matters discussed in this court's order of September 23, 1966, 259 F. Supp. 673, which denied the defendant's motion to dismiss. It is significant to note that the basis of this court's holding—that liability might under some circumstances result from aiding and abetting a violation of Section 10(b) and Rule 10b-5—has continued to find acceptance in the courts. *See Fischer* v. *Kletz,* 266 F. Supp. 180 (S.D.N.Y. 1967); *Ross* v. *Licht,* 263 F. Supp. 395 (S.D.N.Y. 1967).

As has been discussed, MULIC's liability in this case arises not from the express provisions of the Securities Exchange Act, but, rather, by implication from principles of the common law of torts which are applied in order to carry out the Congressional purpose. An essential part of the common law of torts has always been the limitation that a tort-feasor is not liable for a loss unless his tortious conduct was a substantial factor in bringing the loss about. *Retatement (Second) of Torts* § 431 (1965). This limitation has been recognized as applicable to cases of civil liability arising under the Securities Exchange Act of 1934. See *Baird* v. *Franklin,* 141 F.2d 238 (2d Cir. 1944), *cert. den.* 323 U.S. 737, 65 S. Ct. 38 (1944).

The *Baird* case characterizes this limitation as a requirement of "proximate cause." It is clear from the opinion that the element the Court found lacking in that case was a showing that the defendants' conduct had *in fact* caused the plaintiff's loss. The instant case presents this same problem of "causation-in-fact." Sometimes, for reasons of policy which are variously formulated, a defendant's conduct is held not to be the "legal cause" of the plaintiff's loss although his conduct was in fact a cause. An example is the rule of law applied in negligence cases in some jurisdictions that a defendant is liable only for those consequences of his acts which might reasonably have been anticipated as resulting from his acts. The losses in this case were precisely the kind of losses which would naturally be expected to result from the fraudulent acts of Dobich which MULIC aided and abetted. The instant case presents only the problem of determining what losses, if any, MULIC's conduct was *in fact* a substantial factor in bringing about.

The defendant in the instant case contends that MULIC cannot be liable for any of the losses caused by Dobich's fraudulent conduct because these losses would have occurred even had MULIC not aided and abetted Dobich. This contention must be rejected as not supported by the evidence.

As has been discussed, MULIC substantially encouraged Dobich by indicating to him on November 30 and December 1, 1964 that MULICH no longer intended to refer inquiries to the Indiana Securities Commission so long as particular complaints coming to MULIC were satisfied. In addition MULIC encouraged and assisted Dobich by indicating that future inquiries would be referred directly to Dobich rather than to the Commission.

Dobich's experience in connection with the Dellwo matter must have given him reason to believe that the Commission could be quite effective, especially in response to letters of complaint coming from MULIC. It is especially noteworthy in this connection that after having been warned by the Indiana Securities Commission in connection with the Dellwo matter, Dobich did not again make use of the kinds of misrepresentations which the Commission at that time warned him against using. Dobich apparently feared the Commission enough to divert his energies into a somewhat different channel.

In view of his awareness of the powers of the Indiana Securities Commission and of the possible adverse publicity which might have accompanied a report of his activities by MULIC, Dobich must have viewed with alarm MULIC's threat to report him to the Commission once again. And indeed there is direct evidence of this alarm

in Dobich's immediate response to Street's letter of September 28, 1964, a response in which Dobich asked for a personal meeting with two top MULIC executives. This meeting as has been discussed, resulted in a renewal of MULIC's threat, in spite of Dobich's efforts to persuade MULIC to do otherwise. Nothing happened which might have allayed Dobich's fear that MULIC would report him until, on November 30 and December 1, 1964, MULIC sent to Dobich two communications that indicated MULIC was not going to do what it had previously said it would do. And of equal significance, Dobich could discern from these two letters a pattern of behavior on the part of MULIC which would enable him to deliver shares to those who complained to MULIC and thus also prevent them from going to the Commission. Armed with this new knowledge that, thanks to MULIC's change of attitude, disclosure to the Commission was much less likely, Dobich *continued* a fraudulent course of conduct that it is reasonable to infer from the evidence he would not otherwise have continued. In this manner MULIC's encouragement of Dobich contributed substantially to the losses of those members of plaintiff's class who purchased MULIC shares from Dobich on or after December 1, 1964, after MULIC had indicated a change in attitude to Dobich.

It of course cannot be said with absolute certainty that in the absence of encouragement from MULIC Dobich would have acted any differently that he did. But the answer to this is eloquently stated in *Baird* v. *Franklin, supra,* in which Judge Clark quoted with approval from *Davis* v. *Garrett,* 6 Bing. 716, 724, 130 Eng. Rep. 1456, 1459 (C.P. 1830),

> "'But we think the real answer to the objection is, that no wrong-doer can be allowed to apportion or qualify his own wrong; and that as a loss has actually happened whilst his wrongful act was in operation and force, and which is attributable to his wrongful act, he cannot set up as an answer to the action the bare possibility of a loss, if his wrongful act had never been done. It might admit of a different construction if he could show, not only that the same loss might have happened, but that it must have happened if the act complained of had not been done; but there is no evidence to that extent in the present case.'" 141 F.2d at 245, 246.

Judge Clark's opinion in *Baird* v. *Franklin, supra,* was actually a dissent, but his general views on the requirement of "proximate cause" were shared by the majority. He dissented only as to location of the burden of proof.

It is clear from the evidence that Dobich took good advantage of the opportunity MULIC gave him by sending inquiries in his direction. In most instances where customers of Dobich were told by MULIC to contact Dobich, Dobich delivered the shares shortly thereafter.

On November 23, 1964, the president of MULIC learned that Dobich's fraudulent practices with regard to delivery of MULIC shares were continuing despite repeated warnings that MULIC would report his activities to the Indiana Securities Commission. At this point MULIC had available *at least* two alternative courses of action with regard to Dobich. MULIC might then and there have reported what it knew of Dobich's activities to the Indiana Securities Commission. Or MULIC might have acted in a manner which had the effect of putting Dobich on notice that MULIC knew his activities were continuing and that

MULIC did not intend to carry out its earlier threats. MULIC chose the second of these two alternatives. This clearly constituted substantial encouragement to Dobich.

Although not strictly necessary for the disposition of this case, it is appropriate to observe that even if MULIC had not encouraged Dobich by its communications to him of November 30 and December 1, 1964, MULIC also aided and abetted Dobich by its failure to report its knowledge of his fraudulent activities to the Indiana Securities Commission sometime shortly after November 23, 1964. If MULIC had not changed its attitude toward Dobich in an effort to protect the stability of the market for MULIC shares during the Illinois Mid-Continent merger negotiations and ensuing proxy fight, MULIC *would* have written to the Indiana Securities Commission sometime shortly after Schwanz learned of Dillon's complaint on November 23, 1964. This view is not only supported by the record in this cause—it is required by the testimony and reasonable inferences to be drawn therefrom under the unusual circumstances which existed. Moreover, it is clear from the evidence that MULIC had a duty to write such a letter to the Commission as it had clearly warned Dobich on October 12 and 13, 1964 that it would do. If MULIC had chosen to report its knowledge of Dobich's fraudulent activities to the Indiana Securities Commission, agency action would not have resulted in a curtailment of Dobich's activities until approximately December 21, 1964, as will be discussed below. However, MULIC did not report Dobich's activities. If recovery were denied to those members of plaintiff's class who purchased MULIC shares from Dobich on or after December 1, 1964, but before December 21, 1964, MULIC would benefit from the effect of a course of action which he wrongfully rejected.

The defendant, in regard to its failure to report Dobich, contends that a letter from MULIC to the Indiana Securities Commission would have had no effect because the Commission already knew from other sources as much as or more than MULIC knew. This contention is against the weight of the evidence.

There is an abundance of evidence that the Indiana Securities Commission did in fact know of Dobich's practice of slow delivery. No good purpose would be served by reviewing this evidence in detail. Although no letter from MULIC could in itself have added significantly to the Commission's knowledge of Dobich's activities, it does not follow from this that a letter from MULIC would not have precipitated administrative action. On the contrary, the only administrative action by the Commission which is disclosed by the evidence came in response to a single letter of complaint from MULIC recounting misrepresentations allegedly made to Mr. Dellwo. In response to this letter from MULIC, the Commission held a hearing, and after that hearing Dobich did not again engage in conduct of the particular kinds against which he had been warned. Thus, in response to a single letter of complaint from MULIC relating to the details of a single complaint, the Commission took action which proved to be effective. In view of this background, it can only be concluded that the Commission attached special significance to a letter of complaint coming from a company such as MULIC regarding activity in the market for its own shares. It is especially noteworthy in this regard that in his letter to Sheets of June 22, 1964, Deputy Commissioner Mote *asked* MULIC to report further irregularities.

Had such a letter from MULIC to the Indiana Securities Commission been written in the week following November 23, 1964, the Commission would have taken administrative action resulting in termination or significant curtailment of Dobichs fraudulent activities. The process would not, of course, have been instantaneous. The Indiana Securities Commissioner, Martin K. Edwards, testified that a normal time period before a hearing once the Commission decided to hold a hearing was about 15 days. This is in fact approximately the time which elapsed between the Deputy Securities Commissioner's letter to Dobich regarding the Dellwo matter and the hearing which was held on that matter as a result of MULIC's letter in May of 1964. This court cannot determine with certainty the course that such a hearing might have taken or the action which would have resulted from such a hearing. If the Commission had examined the books or records of Dobich Securities Corporation which were then available, as the Commission clearly had the power to do, Dobich's license would have been suspended immediately. It is also possible that the warnings and publicity alone resulting from such a hearing might have forced Dobich to curtail his activities. This court cannot and need not determine with exactitude the manner in which administrative action by the Indiana Securities Commission would have affected Dobich. It is sufficient to observe that a letter from MULIC to the Indiana Securities Commission sometime in the week following November 23, 1964 relating a complaint or complaints of slow delivery or nondelivery by Dobich would have resulted in administrative action by the Commission culminating in a termination or significant curtailment of Dobich's fraudulent conduct no later than December 21, 1964.

Securities Commissioner Edwards and his deputy were succeeded in the office of the Indiana Securities Commission on December 1, 1964 by Thomas Jeffers and Donald Doxsee. However, Edwards remained until the latter part of December, assisting the new personnel and familiarizing them with the office. The fact that the Commission was in a period of transition during the critical weeks of December 1964 does not diminish the likelihood that the Commission would have taken action against Dobich in response to a letter from MULIC. Such a letter, received early in December, would have caused Edwards to have reviewed the history of complaints about Dobich, including the Dellwo matter, with the new personnel, and such a review could only have resulted in some action or proceeding resulting in the prompt curtailment or termination of Dobich's fraudulent activities.

If in early December 1964 MULIC had revealed what it knew about Dobich to the United States Securities and Exchange Commission, an investigation would have immediately resulted and within two weeks after the start of such an investigation, Dobich's fraudulent activities would have been terminated.

This court holds, as previously indicated, that MULIC's affirmative conduct aided and abetted Dobich by providing substantial encoureagement to him (and his organization) which resulted in losses to those members of plaintiff's class who purchased MULIC stock from Dobich on and after the date upon which the encouragement resulted in a continuation of Dobich's fraudulent conduct. Any determination of an exact date beyond which MULIC's conduct contributed substantially to the losses of purchasers of MULIC stock from Dobich lacks mathematical precision.

However, there is no escape from the necessity to make such a determination. December 1, 1964 has been selected as the best and most realistic approximation indicated by the evidence. Under the facts and circumstances of this case, MULIC is liable to plaintiff and those members of plaintiff's class who purchased stock in MULIC from Dobich on or after December 1, 1964, but who did not receive delivery of the shares so purchased. Recovery by members of plaintiff's class is subject to the further terms and conditions of this and any further orders entered herein.

The class on whose behalf this action was brought by the plaintiff is so numerous that joinder of all members of the class would have been impracticable. There are questions of law and fact common to the class, and plaintiff's claims are typical of the claims of the class. The plaintiff has fairly and adequately protected the interests of the class. The court finds that this action was maintainable as a class action under the provisions of Rule 23 of the Federal Rules of Civil Procedure. In its order denying the defendant's motion to dismiss the claim insofar as it was a class action, the court set forth in detail the reasons why a class action is appropriate in the instant case. 259 F. Supp. 673, at 683-684. Nothing in the record now before the court disturbs the finding that a class action is appropriate. The conditions which must be met in order for a member of the class to recover will be set forth.

Plaintiff's alleged class includes 419 individuals who claim losses totaling $2,104,904.75. However, only those members of the class who meet the conditions to be set forth, including the condition of a purchase of MULIC stock from Dobich on or after December 1, 1964, are en-

titled to recover. The total amount recovered will therefore presumably be substantially less than the total amount which has been claimed.

The plaintiff, Tora C. Brennan, who represented the class of plaintiffs in this action, purchased 321 shares of Midwestern United Life Insurance Company stock from Dobich Securities Corporation on April 9, 1965, for which she paid $22,470.00. She never received her stock. The defendant has presented no matters in defense to Mrs. Brennan's claim other than those which are applicable to all members of plaintiff's class. Mrs. Brennan is therefore entitled to recover from the defendant the sum of $22,470.00.

At the close of the plaintiff's case at trial, the defendant moved, pursuant to Rule 41(b) of the Federal Rules of Civil Procedure, to dismiss this action on the ground that plaintiff had not shown a right to relief. The court deferred its ruling on the motion. The motion is denied.

This memorandum contains the court's findings of fact and conclusions of law, as provided in Rule 52(a) of the Federal Rules of Civil Procedure.

JUDGMENT

It is hereby ORDERED, ADJUDGED AND DECREED that Tora C. Brennan, the named plaintiff herein, have and recover of and from the defendant the sum of twenty-two thousand four hundred seventy dollars ($22,470.00) and the costs expended herein both on her own behalf and on behalf of the other members of her class. This portion of the judgment in favor of Tora C. Brennan constitutes the entry of a final judgment pursuant to Rule 54(b), Federal Rules of Civil Procedure, as there is no just reason for delay, and this judgment shall bear interest at the rate of six per cent per annum from date of entry until paid.

It is FURTHER ORDERED, ADJUDGED AND DECREED that each and all members of plaintiff's class who were such members on January 3, 1968, and who purchased stock in Midwestern United Life Insurance Company from Dobich Securities Corporation or any of its agents or sales representatives on or after December 1, 1964 and did not receive delivery of the stock so purchased, have and recover judgment of and from the defendant in the amount of their respective claims for the purchase price for stock not delivered as hereafter established before the special master to be designated by this court in its order of reference to be entered after consultation with counsel and subject to such individual defenses, if any, as the defendant shall establish before the special master in accordance with law. The manner of submitting all claims allowable under the terms of this judgment order and of filing individual defenses, if any, to a particular claim or claims shall be established in such order of reference to the master. The other matters concerning his appointment shall likewise be covered in such order, as required by Rule 53, Federal Rules of Civil Procedure. This portion of the judgment in favor of certain members of the class is not a final appealable judgment as defined in Rule 54(a), Federal Rules of Civil Procedure, and will not become so until final judgment is entitled after approval of the special master's report. No interest shall accrue prior to that date. Provided, however, that each of the individual judgments herein provided for shall be reduced by the sum, if any, which any class member entitled to recover under the terms of this order has received or hereafter receives from any of the Dobich bankruptcies by reason of a claim filed therein which is based upon the same loss for which recovery is provided in this judgment order. Pro-

vision shall be made for such adjustment, if any, by the special master as provided in the order of reference to be entered hereafter.

It is FURTHER ORDERED, ADJUDGED AND DECREED that each and all members of plaintiff's class who were such members on January 3, 1968, and who purchased stock in Midwestern United Life Insurance Company from Dobich Securities Corporation or any of its agents or sales representatives on or before November 30, 1964 and did not receive delivery of the stock so purchased, take nothing by reason of this class action and plaintiff's complaint filed herein, and judgment is entered against each of them and in favor of the defendant. This portion of the judgment against certain members of the class constitutes the entry of a final judgment pursuant to Rule 54(b), Federal Rules of Civil Procedure, as there is no just reason for delay. Counsel for plaintiff and her class is directed to make copies of the judgment section of this Memorandum of Decision and Judgment and cause one such copy to be sent by regular United States mail to each member of plaintiff's class against whom this judgment is entered with a letter advising such class member of the date of entry of this judgment and that a notice of appeal must be filed within 30 days thereof to protect the right of appeal.

The matter of attorney's fees to be awarded to counsel for plaintiff and her class is expressly excluded from the terms of this judgment order and the question of attorney's fees to be awarded out of the funds recovered by class members shall be determined after further hearing and shall be set forth in the order of this court to be entered subsequent to the filing of the special master's report.

APPENDIX C

Court of Appeals Majority Opinion and Dissent

In the

United States Court of Appeals

For the Seventh Circuit

SEPTEMBER TERM, 1968 APRIL SESSION, 1969

No. 17167

TORA C. BRENNAN,

Plaintiff-Appellee,

v.

MIDWESTERN UNITED LIFE INSURANCE COMPANY, a corporation,

Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Indiana, Fort Wayne Division.

SEPTEMBER 29, 1969

Before SWYGERT and CUMMINGS, *Circuit Judges,* and MORGAN, *District Judge.*[1]

SWYGERT, *Circuit Judge.* This is an appeal from a judgment granted the plaintiff in a class action against

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[1] Judge Robert D. Morgan is sitting by designation from the United States District Court for the Southern District of Illinois.

the defendant, Midwestern United Life Insurance Company, on behalf of all persons who bought Midwestern stock from Dobich Securities Corporation but failed to receive delivery of their stock.

Midwestern is an Indiana corporation with its principal place of business in Fort Wayne, Indiana. During the period in question it had a million shares of stock outstanding and over 10,000 stockholders.

Dobich Securities Corporation was incorporated in Indiana in 1963. Michael Dobich owned most of the stock of the corporation and was its president, chief executive officer, and in control of its operations. Dobich Securities' operations were entirely intrastate and under the regulations of the Indiana Securities Commission.

The district court held that Dobich Securities and Michael Dobich violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities Exchange Commission in the sale of Midwestern stock and that Midwestern aided and abetted those violations by both affirmative conduct and silence and inaction after November 30, 1964. The court further held that Midwestern's conduct was a proximate cause of the loss sustained by those who purchased Midwestern stock from Dobich Securities on or after December 1, 1964 and did not receive delivery of their stock.

The principal issue before us is whether the record supports certain findings made by the trial judge, namely, that Midwestern's president, Phil J. Schwanz, and its general counsel, Ralph Sheets, knew prior to November 30, 1964 that "Dobich was dealing in a fraudulent manner with his customers' money," thus violating the securities

laws; thereafter Midwestern intentionally aided and abetted Dobich in order to gain a benefit for itself; and there was a causal relation between Midwestern's conduct and the loss suffered by the plaintiff and the other purchasers of Midwestern's stock who were similarly situated. Two other issues were presented: whether Midwestern had a duty to report Dobich's activities to the Indiana Securities Commission, and whether Midwestern's affirmative conduct, as opposed to silence and inaction, was an issue raised either by the pleadings or tried with the consent of the parties.

With respect to the principal issue our duty is to decide whether the trial judge's findings were clearly erroneous. As stated by many other reviewing courts, we, as an appellate tribunal, may not retry the case or substitute our judgment for that of the trial judge. It is he, who after judging the credibility of the witnesses, weighing the evidence, and drawing inferences, makes factual determinations. Our function is to ascertain, after considering the record in its entirety, whether the inferences drawn by the trial judge have a sufficient evidentiary basis so that it can be said they are reasonable, that is, could have been arrived at by logical deductions. In performing that function, we may not resolve testimonial conflicts or attempt to judge the credibility of witnesses.

The knowledge, motive, design, and intent which underlay the actions of a number of people in this case had to be determined by the trial judge. Such determinations are seldom made on the basis of direct proof. More often they are arrived at by inference from indirect evidence and after the trier of fact has judged the credibility of the witnesses. The latter was the situation in the present

case. Judge Eschbach was well aware of this as indicated by one of the concluding paragraphs in his memorandum opinion which accompanied the district court's decision holding Midwestern liable.[2] He wrote:

> This long and detailed account of MULIC's activities as they related to Dobich Securities Corporation has been necessary because only from an assimilation of a large number of small incidents can ultimate conclusions about MULIC's knowledge and conduct be derived. The unusual facets of this case will be observed in the unique facts and surrounding circumstances which have been disclosed by the evidence and not in any unusual application of legal principles. It is for this reason that an unusually long and detailed statement of facts has been required. No one incident or witness has provided a complete picture of the relevant facts and circumstances. An accurate understanding of MULIC's knowledge and conduct can be derived only from a chain of factors disclosed by many witnesses, exhibits, and stipulations. This case clearly demonstrates that the limits of duties prescribed by the Securities Exchange Act of 1934 '. . . cannot be confined to an abstract rule but must be fashioned case by case as particular facts dictate.' *Kohler* v. *Kohler Co.*, 319 F.2d 634, at 637-38 (7th Cir. 1963).

We cannot agree with Midwestern's argument that the vast majority of the evidence is undisputed and therefore we are free to draw our own inferences regardless of those drawn by the trial judge. Although much of the evidence is either documentary or relates to undisputed events, the import of this evidence was passed upon by the judge in the light of the testimony of witnesses, both

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[2] The memorandum of decision is published in full, *Brennan* v. *Midwestern United Life Ins. Co.*, 286 F.Supp. 702 (N.D. Ind. 1968).

interested and disinterested. Accordingly, credibility determinations were a significant part of the inferences which he drew from the primary facts and testimony. To be expected, Midwestern's defense was to deny any wrongdoing; however, it is evident that the trial court judged the defendant's actions in the light of all the evidence, testimonial and documentary, rather than accepting at face value the self-serving testimony of certain witnesses.

With the foregoing approach in mind, we have considered the record as well as the contentions and arguments advanced by the parties. Although many of the arguments made by Midwestern to demonstrate that the evidence supports findings other than those made by the trial judge are persuasive, the counterarguments made by the plaintiff in favor of the district court's finding are equally so. This is a close case, but our ultimate conclusion is that, on balance, we cannot say that the factual determinations made by the district judge are clearly erroneous.

We believe it would not only unduly lengthen this opinion but would serve no useful purpose to recite in detail the evidentiary background of this case. That background is contained in Judge Eschbach's exhaustive memorandum decision to which we have referred. Rather we shall point out the more important reasons why we think there is sufficient evidentiary support for findings which Midwestern says are erroneous.

I. *Midwestern's knowledge that Dobich was violating the Securities laws*

The district judge found that "Schwanz and Sheets knew well before November 30, 1964 that Dobich was dealing in a fraudulent manner with his customers' money." We believe that a number of events and circum-

stances (many of them alluded to in the district judge's opinion) when considered in combination support this finding.

Schwanz and Sheets knew by reason of the Dellwo incident[3] in May 1964 that Dobich was selling Midwestern stock to his customers and that through one of his salesmen, he had made a number of misrepresentations. In September 1964 they became aware through four complaints from customers of Dobich that his delivery of Midwestern stock was abnormally delayed. As a result, they discussed the possibility that Dobich was using his customers' money as working capital. After September 28 Sheets wrote Dobich that "It appears that you are using your clients' money as working capital, which should not be done." Sheets also expressed concern that Dobich's customers might feel Midwestern was responsible if Dobich was "unable to make good on its obligations to transfer MULIC stock." Dobich responded to this letter by writing to Sheets, "We have developed a substantial interest in your company." He asked for a meeting with Schwanz and Sheets. The meeting occurred on October 12, 1964. Prior to that another Dobich customer complained to Midwestern that he had purchased $7,500 worth of its stock in July and had not yet received a stock certificate. At the meeting Dobich told Schwanz and Sheets that he had stock to deliver, but that his late delivery of Midwestern stock to his customers was caused by the difficulty he was experiencing in getting the stock released from collateral and from other brokers from whom he had purchased Midwestern stock. No attempt was made by Schwanz to verify this explanation although Sheets

[3] The Dellwo affair is discussed at length in the district court's opinion at 286 F.Supp. 702, 708-09.

on the witness stand inferentially admitted the unlikelihood of the story about difficulty with releases of collateral. Schwanz' testimony revealed his awareness of Dobich's late deliveries:

> I can tell you about what he [Dobich] said. "As you know we're selling a lot of your stock." And I said, "Well, you probably are, but I still want fast deliveries. I want deliveries to be normal. I do not want them to be slow." . . . "I don't care what you are selling, its got to be done right or not at all."

In recalling the meeting with Dobich on October 12, Schwanz testified with respect to giving Dobich a two-week deadline period, Dobich had said, "In two weeks time I can be even with the board."

The day following the meeting Sheets wrote to Dobich:

> This will confirm our understanding that within two weeks you will have caused Milwestern United Life Insurance Company stock to be transferred to any persons who have purchased such stock through or from you.
>
> If we receive information after two weeks from now that you are not making transfers to purchasers of MULIC stock within the normal time required of a broker to effect such transfers, we will have to refer future inquiries to the Indiana Securities Commissioner for suitable investigation.

On October 15 two more complaints from Dobich's customers were received by Midwestern. To one, Dobich explained that the stock was in "inventory and any delay in its delivery would be the fault of Midwestern United Life." To the other, he said that he did not want to flood the market with Midwestern stock. Midwestern officials could not help but realize that these explanations were false and they admitted as much on the witness stand.

Moreover, they were completely inconsistent with his story to Sheets and Schwanz on October 12. As plaintiff argues, a broker who is not converting his customers' money does not make flagrantly false misrepresentations to his customers concerning his failure to make delivery of their stock certificates. A third complaint, from George W. Puetz, was received by Midwestern on October 15. Puetz said that stock purchased in June had not yet been delivered. He did not identify the broker from whom he purchased the stock. However, a blind copy of Midwestern's reply to Puetz was sent to Dobich as well as to Sheets.

We believe the foregoing recital of events could reasonably permit the trial judge to find that Midwestern officials knew Dobich was misusing his customers' money, that is, that he was selling Midwestern stock which he did not own and did not then have funds to purchase.

II. *Midwestern's aiding and abetting Dobich's fraudulent actions and its motive for doing so*

The price of Midwestern stock rose rapidly during the last half of 1964. From $69 per share in June there was an increase to $93 per share in December. Dobich Securities presented to Midwestern for transfer approximately twenty-one per cent of the total shares presented for transfer by all brokers from May 1964 until July 1965. That market was thin in Midwestern stock and the effect of the Dobich Securities' buying was to drive up the price of the stock. This seems to have been a substantial reason for the rise in price since Midwestern's earnings for 1964 were less than they were in 1963. Midwestern's officers knew that Dobich was largely responsible for the increased activity in Midwestern's stock and that this had an effect on the price.

On October 27, 1964 merger negotiations began between Midwestern and the Illinois Mid-Continent Life Insurance Company. An agreement was reached the next day that one share of Midwestern stock would be exchanged for ten shares of Mid-Continent stock. Mid-Continent was quoted at $9.50 per share and Midwestern at $88. The ten-for-one exchange ratio was based primarily on the then market price since the adjusted book values of the two companies did not support the exchange ratio agreed upon.

The Mid-Continent stockholders, after a proxy contest, refused to approve the merger in February 1965. During the proxy fight the officers of Mid-Continent argued that, "The adjusted book value of the share has little relationship to the value of the shares in that the value of the shares is primarily established by the market value in over-the-counter trading."

Schwanz admitted that it would have been embarrassing for Midwestern if the SEC or the Indiana Securities Commission had investigated Dobich while they were in the middle of the proxy fight in Chicago. He also admitted that if Dobich Securities had been put out of business in November or December 1964, there could have been a serious decline in the bid and asked price of Midwestern stock.

The district court found that a pronounced change in Midwestern's attitude took place between October 13 (when Sheets wrote Dobich that, if Midwestern received any information after two weeks about Dobich's late delivery of stock, future inquiries would be referred to the Indiana Securities Commission for "suitable investigation") and November 30. We are convinced that the court was justified in adopting such a view.

After receiving the October 13th letter, Dobich sent lulling telegrams and letters to his customers who had purchased Midwestern stock but had not received their certificates. A typical telegram read in part: "Midwestern United Life has made a nice move upward. Dobich Securities Corporation has worked hard to alert the public to this situation. If you are late receiving your certificate, do not be alarmed. We are now solving that problem." A typical letter read in part:

> Please do not become alarmed if delivery is made later than usual because we are creating a heavy interest in this particular stock. The unusualy large volume has two effects; it makes our processes a little slower and at the same time, it causes your holdings to increase in value.

This maneuver by Dobich apparently worked for a time because Midwestern received no complaints between October 15 and November 23.

On November 23 Robert Dillon was visited by two Midwestern agents. Dillon had purchased 200 shares of Midwestern stock in September 1964. Some time later he received one of the lulling telegrams and a follow-up letter. Dillon inquired of the agents how long it took to transfer Midwestern stock. He did not identify the broker from whom he had made his purchase; however, one of the agents said, "I hope you are not talking about Mr. Dobich." The agent immediately called Schwanz who then discussed the matter with Sheets. Thereafter, on November 30, Sheets wrote two letters, one to Dillon and the other to Dobich. The letter to Dobich read in part:

> We are suggesting to Mr. Dillon that, in the event he does not receive his stock immediately or does not receive a satisfactory explanation for the delay, he turn the matter over to his personal attorney and/or contact the Indiana Securities Commissioner.

Dillon received a carbon copy of this letter along with a letter suggesting that if he did not hear from Dobich "right away," he should contact either the Indiana Securities Commissioner or his personal attorney.

The same procedure was followed with reference to a complaint sent to Midwestern on November 30 by Frederick Volkee except that Dobich was sent a blind carbon copy of Midwestern's response to the complaining customer.

With respect to complaints received from Dobich's customers after December 1, 1964, Midwestern followed a procedure which effectively foreclosed the possibility that complaining customers would proceed before the Indiana Securities Commission. Those who inquired about the delay in the delivery of their stock from Dobich were advised to first contact Dobich Securities. Some were further advised to proceed before the Indiana Securities Commissioner if a satisfactory explanation or delivery was not made by Dobich. Midwestern's letters were a signal to Dobich. They directed customers to contact Dobich and thus allowed him to arrange for delivery without fear of any Indiana Securities Commission interference.

We agree with the district judge's appraisal of the Dillon letter on November 30. Judge Eschbach's memorandum opinion on this matter read:

> Sheets' letter to Dobich on November 30 . . . gave Dobich an opportunity to deliver to Dillon and keep Dillon away from the Securities Commission. It must be remembered that until this time, Dobich had no reason to think that if a complaint about late delivery

> came to MULIC, MULIC would do anything less serious (from Dobich's point of view) than forward the inquiry directly to the Indiana Securities Commission. It is reasonable to conclude that Dobich, until this time, had good cause to fear that MULIC might even take its whole history of complaints to the Commission. Dobich had tried at the October 12 meeting to convince Schwanz and Sheets that he was worth protecting, but up until November 30 Dobich had no reason to suspect that his efforts had been successful. So it must have come as an extremely pleasant surprise to Dobich to learn that so long as he delivered Dillon's shares, MULIC would keep still. Nowhere in his letter did Sheets suggest that Dobich was appropriating his customers' money or that his conduct was improper or that Dobich was giving MULC a bad name. In short, all the expressions of generalized concern about Dobich's activities, so evident in the letters of September 28 and October 13 and in the meeting of October 12, were gone. In their place was a letter indicating that so long as the *particular* complaint was satisfied, MULIC had no further concern.

We also agree with the judge's view that Dobich would interpret the Dillon letter to mean that Midwestern did not intend to carry out its threat to refer future inquiries to the Indiana Securities Commission; rather, that Midwestern would give him an opportunity to continue in business so long as he satisfied complainants by prompt delivery of their stock. Further, it is reasonable to infer that Sheets must have known Dobich would interpret the Dillon letters in this fashion.

The reason for this change of attitude on Midwestern's part is not hard to guess. Midwestern was trying to accomplish the Mid-Continent merger. It was to Mid-

western's advantage to keep its stock at the price it was selling for in November and December. If the price declined, the success of the merger was endangered since the merger was based upon the relative market values of the two stocks. This rise in price of Midwestern's stock had been generated by Dobich's abnormal selling activities which in turn required him to cover his short sales in a thin market. If Dobich's operations were reported either to the Indiana Securities Commission or the SEC by Midwestern, those operations would undoubtedly have come to an end and the prop holding up the price of Midwestern's stock would no longer exist.

We believe that the district judge could reasonably reach this conclusion after considering all the evidence. We also believe that it was reasonable to conclude further that the procedure adopted in the Dillon matter and thereafter encouraged Dobich "to continue his activities without fear of a report from MULIC to the Indiana Securities Commission," and that this encouragement substantially aided and abetted Dobich in the continuation of his fraudulent operations after December 1, 1964. We think it was also reasonable to conclude that Midwestern aided Dobich in the continuation of his fraudulent activities by not carrying out its threat contemplated in its October 13th letter and by its failure to report either to the Indiana Securities Commission or the SEC its knowledge of Dobich's activities after realizing that Dobich did not intend "to be even with the board" as he promised. Under the circumstances, this calculated silence constituted part of Midwestern's plan to aid and abet Dobich in his fraudulent activity.

III. *The causal connection between Midwestern's misconduct and the injury suffered by the members of the class*

The district court found that except for either Midwestern's misconduct in actively assisting and encouraging Dobich commencing with issuance of the Sheets' letter on November 30, 1964 or its failure to report Dobich's activities to the Indiana Securities Commission, Dobich would have ceased his fraudulent activities on December 1, 1964 or would have been forced to do so by actions of the Securities Commissioner on December 21, 1964. As we previously stated, it is our view that the district court was justified in its interpretation of the November 30 letter as indicating Midwestern's intention not to refer inquiries directly to the Indiana Securities Commission so long as the specific complaints about tardy delivery received by Midwestern were satisfied by Dobich. By referring directly to Dobich the complaints of dissatisfied customers who potentially could file charges before the Securities Commission, the possibility that the Securities Commission would interfere was substantially reduced. This affirmative conduct on Midwestern's part facilitated the commission of Dobich's fraud because it armed him with the knowledge that complaints to Midwestern would be referred to him first rather than to the State Commission.

The active assistance of Midwestern was not the only cause of customer loss after December 1, 1964. If Midwestern had reported its knowledge of Dobich's fraud to the Indiana Securities Commission, the evidence showed that the Indiana Securities Commission would have put Dobich out of business. Notwithstanding scattered failures

on the part of the Indiana Securities Commission to follow up earlier complaints concerning Dobich's slow delivery of securities, the district court could reasonably believe the testimony of Martin K. Edwards who was the State Securities Commissioner on December 1, 1964. He testified that if Midwestern had reported all of the information concerning Dobich's conduct in its possession in late November 1964, the Indiana Securities Commission would have suspended or revoked Dobich's license. Further support for the finding that the Indiana Commission would have acted if Midwestern had reported Dobich's misconduct is found in the presumption that public officials properly discharge their official duties. *Harrell* v. *Sullivan,* 220 Ind. 108, 116, 40 N.E.2d 115, 118 (1942).

IV. *Midwestern had a duty to report Dobich's activities to the Indiana Securities Commission or the SEC*

The silence theory that underlies this case is that Midwestern, by failing to report Dobich's activities to the SEC or the Indiana Securities Commission, knowingly and purposefully encouraged an artificial build-up in the market for its stock so that it would be in a more favorable position to consummate the potential merger it was then negotiating. It is our view that the district court was correct in concluding that Midwestern's acquiescence through silence in the fraudulent conduct of Dobich combined with its affirmative acts was a form of aiding and abetting cognizable under Section 10(b) and Rule 10b-5. Here Midwestern's failure to report Dobich after December 1, 1964 was more than omission; it was a signal to Dobich that further inquiries would not be handled as earlier threatened, and that Dobich would be given an opportunity to cover his non-deliveries. Without deciding

whether the failure to report Dobich's activities to the Indiana Securities Commission would in itself give rise to liability under Rule 10b-5, we find that under all the facts and circumstances of this case, Midwestern's actions amounted to a tacit agreement with Dobich to prevent complaints from reaching the Commission, thus facilitating the fraud and allowing Dobich's scheme to continue to Midwestern's benefit. Violations of this rule should be "fashioned case by case as particular facts dictate." *Kohler* v. *Kohler Co.*, 319 F.2d 634, 637-38 (7th Cir. 1963). The district judge was correct in saying:

> A basic philosophy of the Seurities Exchange Act of 1934 is disclosure and is directed toward the creation and maintenance of a post-issuance securities market that is free from fraudulent practices. The investor's protection is the paramount consideration of much of the federal securities legislation and, in particular, of the 1934 Act here involved. The effect on an investor of an issuer corporation's failure to disclose improper activities of a brokerage firm dealing heavily in the issuer's stock, where the broker's activities create an appreciable risk of loss to that investor, may be just as dangerous and equally as damaging as a failure by the issuer to disclose information of its own improper activities affecting the value of its stock. The loss to the investor may well be the same. 259 F.Supp. at 680.

V. *The issue of Midwestern's affirmative misconduct was properly before the district court*

Midwestern claims that it was deprived of the right to prepare for and defend against the charge of affirmative action constituting encouragement to Dobich and causing him to continue a course of action which he would not

otherwise have pursued. Midwestern protests that "at no time prior to this appeal did either party brief or argue" the affirmative misconduct theory. Although the complaint only alleged silence and inaction, Midwestern's motion for a more definite statement said that the "aiding and abetting by defendant intended to be asserted [in the complaint] is its failure to report the conduct of [Dobich] but the allegation is not so limited." Also, the affirmative acts relied on were in furtherance of a plan of nondisclosure as discussed above, so that questions decided on one theory of wrongdoing necessarily have a bearing on the other.

An indication of the notice that Midwestern had of the scope of proof is contained in the plaintiff's objections to the defendant's pre-trial statement of issues: "the evidence may actually show a deliberate purpose on the part of the Defendant." At trial, defense counsel specifically inquired of witnesses whether they had engaged in action to aid and abet Dobich. Finally the trial judge's decision stated that: "When trial commenced, both sides were well aware of the evidence upon which each side has based its claims or defenses. If in any respect the pleadings do not strictly conform to the evidence, no prejudice to either side could have resulted therefrom." We agree.

The judgment of the district court is affirmed.

No. 17167

DISSENTING OPINION. MORGAN, *District Judge.*

If I could find any credible evidence to support it, I would concur in this decision. I do have the utmost and profound respect for the wisdom and general fairness

of my judicial superiors on this panel, as well as for my senior brother who decided this case below; and I confess a very strong desire to vote for affirmance of a district judge, especially on an evaluation of evidence; and I do feel the natural sympathy for each of the several hundred persons who were defrauded so grossly by Mr. Dobich. However, I am simply unable to substitute these feelings for the minimum evidence of fault I believe is and should be necessary to establish liability. I must respectfully dissent.

It seems to me that the trial judge's Memorandum of Decision itself (286 F.Supp. 702) shows that the decision rests on a compounding of wholly unjustified inferences and upon pure speculation, and that it results in creation of tort liability without any real suggestion of fault in the evidence. It also seems to me that the majority opinion here, while enunciating sound but inapplicable principles of law in scholarly fashion, fails to come to grips either with the real questions of proof involved or the unsound process of reasoning employed below. Judge Swygert states that conclusions must be arrived at by "logical deduction." I agree. I would most certainly not undertake to resolve testimonial conflicts on appeal, but I must disagree with the logic of the deductions which led to this judgment. It is respectfully observed that simply saying conclusions have been derived from much complex evidence neither makes that statement true nor makes those conclusions logical.

It is now abundantly clear (as correctly found and related by the trial judge) that, at the time of his death

in July, 1965, Mr. Michael Dobich[1] had failed to make delivery of many thousands of shares of Midwestern stock, for which some several hundred customers had paid him approximately $2,900,000; that he had pursued a consistent practice of making fraudulent short sales of this as well as other stocks to a great many people; that he had violated the securities laws and regulations of his state and nation most grossly; and that his corporation was actually deeply insolvent before there was any contact between him and the defendant. It seems equally clear to me that there is simply no evidence whatsoever in the record that the defendant, Midwestern, had any actual knowledge or even any faint suspicion of his financial condition or his operations, or that it was in any way involved with Dobich (or in any way connected to this fraudulent mess), except in a few very definite and specific ways which are undisputed in the record. The whole fabric of the decision rests on those involvements and connections, not on conflicts in testimony. One may refuse to believe all of defendant's witnesses and accept implicitly all of the competent testimony of plaintiff's witnesses and still there is simply nothing to suggest more than a highly speculative possibility that defendant could have any knowledge of any fraud, much less that it engaged in any intentional aiding or abetting thereof.

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[1] It seems unnecessary to distinguish for any purpose here between Mr. Dobich and Dobich Securities Corporation, through which his fraudulent depredations may all nominally have been carried out. He controlled the operation completely and was apparently a skilled "confidence man" of the first magnitude. He "conned" his own salesmen. The trial judge is impressed that a Midwestern officer began a letter to him "Dear Mike," after a single meeting, but does not notice that the Indiana Securities Commission also addressed him this way on occasion.

Furthermore, the trial judge did a thorough job of canvassing an immense trial record for the true facts disclosed thereby and a conscientious job of relating all of the evidence that was in any way significant in his memorandum. I have found nothing of significance, which could conceivably lend support to the decision, which the trial judge did not relate. It does not seem to me that the majority opinion here states anything additional.

Boiled down, the analysis of the evidence and the process of reasoning employed by the trial judge is, that since Midwestern's top management knew from the Dellwo incident in June, 1964, and the subsequent events from August to December 1, 1964, that Dobich had once permitted what the Indiana Securities Commissioner called "rumors" and "unreasonable spreads," that Dobich was concentrating a sales effort on Midwestern stock, that he had been late in delivering stock to some ten customers (all of which was eventually delivered), and that he had concocted false reasons for his lateness, they "knew well before November 30, 1964 that Dobich was dealing in a fraudulent manner with his customers' money." The majority opinion here goes further to find that this all shows it reasonable to conclude that Midwestern management knew "he was selling Midwestern stock which he did not own and did not then have funds to purchase." These conclusions seem to me to be monumental *non sequitur* in relation to the stated premises. There is simply nothing here to suggest damaging fraud, must less anything whatsoever about Dobich's financial condition. Such knowledge of fraud on the part of the Indiana Securities Commissioner is not inferred, yet the record shows clearly and beyond dispute that the Commissioner had received numerous complaints of late delivery of various stocks by

Dobich, going back to 1962, which he accumulated in one Dobich file but considered completely resolved in each instance by subsequent delivery.

It is certainly recognized that any single day any broker has his customers' money, before he buys the stock for which the money was paid, he may be, and presumably is, using that money as working capital. Any abnormal delivery delay suggests a "short sale" to any knowledgeable person. This simply does not suggest fraud, however, or make a short sale fraudulent. There simply is no harm of any kind to the purchaser who ultimately receives his stock, unless there is no accounting for intervening dividends or he is unable to sell the stock when he wants to because he doesn't yet have it. There is no suggestion of either circumstance here. Presumably that's why "lateness," which was crowned by eventual delivery, didn't excite the Indiana Securities Commissioner, whose office exists to police such things.

An inference of any knowledge of actual Dobich fraud by Midwestern on the evidence here, therefore, seems totally unwarranted and very unjust. It is noted particularly, however, that the trial judge doesn't suggest ground even for any suspicion, either by Midwestern or the Indiana Securities Commissioner, that Dobich was vastly short and unable to deliver at any point, because he actually was observed to deliver regularly, in substantial volume long after November 30, 1964, on complaints received either by the Commission or Midwestern and referred to Dobich with a demand for delivery. There were 22 such to the Commission after December 1, 1964, leading to transfers up to two days before Dobich's death in July, 1965.

The stipulated fact that Dobich was responsible for actual transfer on the books of Midwestern of 22,319 shares for 362 people between May and December, 1964, hardly makes "lateness" in ten cases look like he couldn't deliver, especially when he did quickly deliver on complaint. This suggests only that he could do so. Long and detailed judicial recitations of Dobich's "lulling" tactics to many other customers not known to Midwestern, and of the depth of his actual insolvency, known only to himself at that time, contribute nothing to showing guilty knowledge of this defendant.

From this wrongly inferred and thus false premise of known Dobich fraud on or before November 30, 1964, however, and the obvious fact that Midwestern's officers rather naturally liked to see a high market for its stock, the trial judge reasons that Midwestern's officers' failure to notify the Indiana Securities Commissioner of complaints of late deliveries by Dobich, coupled with their notification to Dobich of such with a simple demand for delivery, on penalty of report for failure, substantially encouraged Dobich and thus amounted to aiding and abetting his fraud, because if they had told the Securities Commissioner what they knew, we are told he would have put Dobich out of business in December, 1964. The majority here finds in this picture, without relating evidence of it, a "plan" on the part of Midwestern "to aid and abet Dobich in his fraudulent activity."

These conclusions seem to me to rest on nothing but pure judicial speculation and conjecture and to be directly contrary to the only logical inferences which are possible from the evidence. Nothing in the letter to Dobich of November 30, 1964, concerning the Dillon complaint, or the letter of December 1, or subsequent practice, in any way retracted

previous threats of exposure to the Indiana Securities Commission or indicated the slightest toleration of late delivery of Midwestern shares. I simply am unable to comprehend how they could have, as my esteemed brothers in the judiciary have said they did, in any way amount to a "signal" or indicate to Dobich in any manner either that he was thenceforth free of the previous threat or what Midwestern would do or would not do on any future complaint. On the contrary, the opposite inference seems unavoidable from the evidence, that this practice simply saved one step in correspondence because it did obtain delivery of the shares involved, which, as clearly shown by the Indiana Securities Commissioner's own testimony and his file record, was the maximum extent of his interest in late delivery complaints. His statement that had be been advised of the nine complaints of late, but eventual, delivery which came to Midwestern over the period of four months prior to December 1, 1964, he *would have* instituted an audit and revoked the Dobich license, seems to me nothing short of ridiculous in view of the facts that he had never done that in any case in his four-year tenure, that he had "by far" more work than he could handle generally, that this action would have required a special administrative appropriation for auditors, and that he didn't do it at any time thereafter, in spite of the twenty-two complaints he did receive about Dobich thereafter. Not only is this self-serving assertion not testimony of a fact within the knowledge of the witness, but it seems much more like a whimsical wish of what might have been had he followed the clues it is now said Midwestern should have followed. Fraud such as this naturally seeks a scapegoat, and one with an apparently deep pocket is naturally most desirable. His "would have" action is wholly belied by his prior and subsequent practice, and this "testimony"

seems to me so tainted by hindsight and so speculative as to be completely beyond serious judicial reliance as evidence. Yet the trial judge and the majority here treat this assertion as the certainty which supports the whole theory of causal connection and thus of "aiding and abetting" on which liability is founded.

It is respectfully suggested that the reasonable presumption that public officials discharge their official duties hardly survives undisputed evidence that the official involved has not done on twenty-two later complaints the very act sought to be presumed that he would have done if he had known of nine earlier complaints.

Some suggestion is made that notice from Midwestern to the Commissioner of late delivery by Dobich would have had, and could reasonably have had, greater weight than such notice from other sources, such as the investors themselves. Any logic or justice in that idea escapes me completely. It seems clear that the total failure by anyone to discover the facts behind the complaints was the important thing lacking here, and not who might have made complaints to the Commissioner. It is apparent that the Commissioner knew more than Midwestern, about more cases of lateness and over a longer period. He had a public duty to perform. Midwestern management had an insurance company to run as well as supposed shareholders to keep happy. That was their primary duty. The plaintiff here and others in her class could also have complained to the Commissioner. The sad fact is that most of them didn't, and the Commissioner *didn't do* what he could have done even though he had far more reason to have a suspicion of fraud than Midwestern is now told amounts to *knowledge* of fraud and *aiding and abetting* on its part. The fact that the Commissioner didn't suspect what Dobich

was actually doing, as *nobody* did, and hence didn't take the action *he alone could take,* is a tragedy precipitated by a very busy and clever confidence man; but I am wholly unable to pretend that his whimsical wish and his finger pointing can somehow justify judges in finding one person (Midwestern), who simply didn't tell him all they knew, liable to several hundred others who didn't either. The folks in plaintiff's class didn't notify Midwestern!

Midwestern's action on a late delivery complaint always consisted of taking prompt action to see that Dobich did make delivery to persons it was informed had bought its stock from him. It failure to suspect fraud is far less culpable than the same failure on the part of the Indiana Securities Commission because it had less to go on. Its action in obtaining delivery simply did not help Dobich in any way to "lull" others or to avoid complaints to the Commissioner by others.

The trial court says that, because Dobich's explanations of slow delivery were not truthful, as intelligent and responsible businessmen, Midwestern management "must have realized that there were others who had purchased shares from Dobich *without* getting delivery." That seems patent *non-sequitur* on its face; and it is beyond my comprehension how Dobich's actual delivery after complaint, and sometimes before or coincidental with complaint, can possibly be thought to suggest anything but slow delivery which did regularly become actual delivery. It just doesn't suggest non-delivery or inability to deliver. It suggests the opposite. It must not be overlooked, as noted above, that Dobich, in this period from May through December, 1964, made 362 transfers of Midwestern stock involving 22,319 shares. From January through July, 1965, he made 899

transfers involving 48,409 shares. How fast or slow they were was not known to Midwestern, except for the few who complained of slow delivery and then received their shares. This simply does not suggest in the slightest way, however, that some unknown other people weren't getting the shares they had bought from him. The knowledge that everyone now has, that many people were not, is simply not chargeable in justice to anyone but Dobich in November, 1964.

There is nothing but the trial judge's pure conjecture (and the Indiana Securities Commissioner's incredible self-serving "would have" statement at the trial several years later) to indicate that Midwestern's program for obtaining delivery from Dobich "was much less likely to result in curtailment of Dobich's activities than a report to the Commission would have been." According to all available evidence at the time, and all credible evidence at the trial, the programs of the Indiana Securities Commissioner and Midwestern, on receipt of a complaint for late delivery of shares by Dobich, were identical, *i.e.*, write Dobich and demand delivery on threat of legal action and chalk that problem down as successfully solved when delivery was made thereafter. How any inference can possibly be drawn that earlier curtailment of Dobich's activities even might have been achieved by report of a few more late deliveries to the Commissioner seems absolutely preposterous to me.

Without evidence of knowledge of Dobich's fraud by Midwestern *and* some action or inaction by Midwestern which really did aid or abet that fraud, liability is unsoundly held. There must be some credible evidence of *both*. Here there seems to me no evidence or logical infer-

ence of either. Even if both inferences, which seem the antithesis of logic, however, are accepted, the decision runs afoul of the principle that justice does not permit compounding of inferences. See *United States* v. *Ross*, 92 U.S. 281, 283-284. The decision here seems to pile illogical inferences to a depth of confusion and thus seems to me wholly unsound.

It is suggested by the trial judge and the majority here that Midwestern gained, or *may have sought to gain*, a benefit by protecting Dobich, in that putting him out of business while he was dealing heavily in its stock would have caused a decline in its market value and been embarrassing in merger negotiations. While possibly true, that simply suggests a possible motive and contributes nothing by way of evidence to indicate knowledge of fraud or aiding and abetting its perpetration. The compounding of invalid inferences as to knowledge and help is not supported in the slightest by further speculation as to motive. This also overlooks completely that Dobich could not prop up the price of Midwestern shares by any shares he was selling *until he did buy* to cover his sales. If Midwestern had had any idea that he was not buying any substantial number of shares for which he was absorbing market demand by sales, they could not have thought, and I don't see how judges can think, he was supporting the market price. The opposite would be true. If his visible activities were notice that he was holding up the market price, they just can't also be notice of his fraud.

I find it completely impossible to infer in the slightest degree from any evidence in the record here that Midwestern's effective action to get delivery of its stock to purchasers thereof who complained to it amounted "to a tacit agreement with Dobich to prevent complaints from

reaching the Commission, thus facilitating the fraud and allowing Dobich's scheme to continue to Midwestern's benefit," as stated in the majority opinion. Such a conclusion seems to me not to follow logically from any stated premise, and from my understanding of the record, it seems based upon absolutely nothing but judicial suspicion, conjecture and speculation. Such a conclusion, unsupported by any reasonable inference from evidence, gains no validity by repetition.

While a trial judge's findings of fact, if there is substantial evidence to support them, are entitled to great weight, reversal should take place where the trial court misapprehended the effect of undisputed evidence. *Hart* v. *Gallis,* 275 F.2d 297, 299 (7th 1960). See also *Wigginton* v. *Order of United Commercial Travelers,* 126 F.2d 659, 661 (7th 1942), *cert. den.,* 317 U.S. 636, and *Plufgradt* v. *United States,* 310 F.2d 412, 415 (7th 1962).

Justice does simply not permit blame to be based solely on conjecture in the guise of inference. *Moore* v. *Chesapeake & Ohio Ry. Co.,* 340 U.S. 573, 578 (1951); *Iwaniuk* v. *Bethlehem Steel Corp.,* 402 F.2d 309, 311 (7th 1968); *Euson* v. *Starrett,* 277 F.2d 73, 75-76 (7th 1960). Disbelief of defensive testimony simply doesn't supply affirmative evidence of fault or wrongdoing which is needed to support a judgment of liability. *Moore* v. *Chesapeake & Ohio Ry. Co.,* 340 U.S. 573, 576; *Bankers Life* v. *Guarantee Reserve,* 365 F.2d 28, 33-34 (7th 1966), *cert. den.,* 386 U.S. 913 (1967).

The undisputed evidence shows clearly that what Midwestern is accused of doing affirmatively here is exactly what the Indiana Securities Commissioner always did on complaints of late delivery. That is simply not evidence of knowledge of or complicity in Dobich's fraud on the

part of either. The only failing of which Midwestern is accused is failing to report each complaint of late delivery to the Commissioner. That it admittedly didn't do. Neither did the plaintiff. Instead, Midwestern did what the Commissioner almost certainly would have done. The only legal duty to make such a report of which we are told is a completely fictitious one supposedly created by Midwestern's own threat to do so and supposed knowledge of the fraud, which the evidence clearly shows no one really had. I can find no evidence of any knowledge or suspicion on the part of Midwestern of Dobich's fraud prior to his death, or any basis for inference thereof. I can find no evidence or basis for inference that Midwestern contributed anything to it, intentionally or otherwise.

While I agree that the issue of any affirmative misconduct by Midwestern was properly before the trial court, for the reasons stated in the majority opinion, I cannot agree that any such was proved or even reliably suggested, or that any case whatsoever for liability has been made against Midwestern here. For the reasons stated herein, I would reverse the judgment and dismiss the complaint with prejudice.

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No. 1143

In the Supreme Court of the United States

OCTOBER TERM, 1969

MIDWESTERN UNITED LIFE INSURANCE COMPANY,

Petitioner,

vs.

TORA C. BRENNAN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the
Supreme Court of the United States

OCTOBER TERM, 1969

NO.

MIDWESTERN UNITED LIFE INSURANCE COMPANY,

Petitioner,

vs.

TORA C. BRENNAN,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner Midwestern United Life Insurance Company, (hereinafter referred to as MULIC), defendant-appellant in the court below, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

Opinions Below

The opinion of the United States District Court for the Northern District of Indiana, Fort Wayne Division, denying MULIC's motion to dismiss the complaint is reported at 259 F.Supp. 673 (1966) (App. A., 1-24[1]). The District Court's opinion on the merits is reported at 286 F.Supp. 702 (1968) (App. B, 25-86). The opinion of the United States Court of Appeals for the Seventh Circuit is reported at 417 F.2d 147 (1969) (App. C, 87-115).

Jurisdiction

The decision of the Court of Appeals was rendered on September 29, 1969. A petition for rehearing *en banc* was filed on October 13, 1969 and denied on November 5, 1969.

Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Does Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 of the Securities and Exchange Commission impose a duty upon corporations to police the conduct of brokers dealing in their securities and to report irregularities to the SEC or a state regulatory commission when the corporation has no connection or relationship with the broker and is not trading in its own securities? Under Section 10(b) or Rule 10b-5 are corporations subject to civil liability to persons injured by the misconduct of an independent broker if they fail to report to the regulatory agencies under the circumstances described above?

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[1] App. ....." refers to the separate appendix, submitted with this petition, containing the three prior opinions in this case. "A. ....." refers to the two volume appendix filed in the Court of Appeals. "R. ....." refers to the record on appeal in the Court of Appeals.

2. There is confusion and conflict among the Circuits as to the proper standards for reviewing inferences drawn by a trial judge under Rule 52(a), and with respect to the burden of proof and the propriety of compounding inferences in the expanding area of civil liability for securities and business fraud. These conflicts should be resolved by this Court. Here the District Court's findings of "knowledge" and "proximate cause" were admittedly reached by pyramiding inferences and shifting the burden of proof to defendant. Did the Court of Appeals err in approving those rulings and holding that on review inferences of the trial court must be accepted if they "*could*" have been reached by logical deduction?

Constitutional and Statutory Provisions Involved.

Section 10(b) of the Securities Exchange Act of 1934 provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> "(b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 of the Securities Exchange Commission (17 C.F.R. § 240.10b-5) (1968) provides:

> "It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of a national securities exchange,

"(a) to employ any device, scheme or artifice to defraud,

"(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, or

"(c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

Rule 52(a) of the Federal Rules of Civil Procedure provides in pertinent part:

"(a) *Effect.* In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; . . . Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. . . ."

STATEMENT OF THE CASE.

Plaintiff Tora C. Brennan on behalf of herself and all others similarly situated filed suit on November 19, 1965, against defendant Midwestern United Life Insurance Company, an Indiana corporation whose shares are publicly traded over the counter, alleging that MULIC was liable to plaintiff for losses suffered as a result of her purchase of the capital stock of MULIC from Dobich Securities Corporation, an Indiana licensed intrastate securities dealer. (A. 1, 5, 62, 65.)

Michael Dobich, the principal of Dobich Securities Corporation, was killed on July 10, 1965. Plaintiff and several hundred other persons who had purchased nearly $3,000,000 worth of the petitioner's stock from Dobich had not received delivery of their shares. It was soon revealed that Dobich Securities Corporation had not owned the shares it purported to sell, had not made covering purchases, and was utterly insolvent. (A. 65, 292, 294.)

Unbeknown to petitioner, Dobich was operating a "bucket shop." His technique was to sell large quantities of stock of various companies, particularly insurance companies, without making the covering purchases necessary to deliver the stock sold. After developing a short position Dobich would endeavor to depress the value of the stock and then make purchases of the depressed stock so as to cover his short sales at lower prices. Meanwhile he was using his customers' money for private speculation. Dobich was an extraordinarily accomplished confidence man. For many years he was able to deceive thousands of customers as well as the Indiana Securities Commissioner and many of his own salesmen, who themselves purchased stock from Dobich. (See A. 165-226, 320-22, 377.)

In contrast to his skill as a confidence man, Dobich's speculations as an investor were disastrous. As his private losses increased, diversion of customers' money mounted. While Dobich maintained the appearance of prosperity, it was revealed upon his death that he and his corporation had been hopelessly insolvent since long before the spring of 1964 when he first began dealing in the petitioner's stock. (A. 349, 351-52.)

Petitioner first heard of Dobich in May of 1964 when a MULIC shareholder complained to petitioner's president that a Dobich salesman had attempted to sell him MULIC stock on the basis of a false rumor that petitioner was planning to acquire another insurance company. The sale price offered by the Dobich salesman was five points above the quoted over-the-counter market. MULIC verified the complaint and communicated it to the Indiana Securities Commissioner. Other than calling in Mr. Dobich and "warning him" about unreasonable spreads and false rumors, the Indiana Securities Commissioner did nothing. (A. 185-90, 563.)

Petitioner next heard about Dobich in August of 1964 when it received a letter from a customer of Dobich's who reported that he had purchased petitioner's stock from Dobich on May 27 and had not yet received the certificate. By September 28, 1964, petitioner had received three more complaints of slow delivery and on that date petitioner's general counsel wrote a letter to Dobich demanding that he speed up his delivery of its shares. (A. 82, 85, 87, 89-91, 511.) Unbeknown to plaintiff, the Indiana Securities Commissioner had received at least 17 complaints about Dobich by September 28. (A. 161-207, 304-05.)

On October 6, petitioner received another late delivery complaint. Petitioner demanded that Dobich con-

tact both the complaining customer and petitioner about the transaction. (A. 92-94.) In response Dobich met with petitioner's president and general counsel on October 12. He claimed that he was selling a great deal of petitioner's stock, that the stock that he owned was pledged for collateral, and that he was having difficulty obtaining release of the shares needed for transfer and getting delivery from other brokers. Dobich indicated that it would take him two weeks to become current. Petitioner's officers demanded that he do so. (A. 473-78, 575-81.) The following day petitioner's general counsel wrote to Dobich stating (A. 95):

> "... If we receive information after two weeks from now that you are not making transfers to purchasers of MULIC stock within the normal time required of a broker to effect such transfers, we will have to refer future inquiries to the Indiana Securities Commissioner for a suitable investigation."

Within the next few days petitioner received three more complaints about slow delivery. Complaints to petitioner then ceased for some six weeks until November 23, 1964, when one additional complaint was received. (A. 96-99, 587, 667, 672-73.)

As was subsequently revealed, however, Dobich had done nothing in this period to clear up his problems and, to the contrary, had added to his short position in MULIC by some 3,700 shares having a value of over $300,000.00. (A. 331-32; R. 581-618, 1621-2179, *passim*.)

On November 30, 1964, petitioner's general counsel wrote to Dobich reporting petitioner's advice to the latest complaining purchaser (A. 105):

> "... We are suggesting to [the purchaser] that, in the event he does not receive his stock immediately

or does not receive a satisfactory explanation for the delay, he turn the matter over to his personal attorney and/or contact the Indiana Securities Commissioner.

"I hope it will not be necessary for him to take this action."

A copy of this letter was sent to the customer, along with a letter suggesting that the customer contact the Commissioner if prompt delivery were not received, and providing the Commissioner's name and address. (A. 104-05.)

Substantially identical treatment was accorded a complaint received on November 30, 1964. At the time that these letters were written, all customers who had previously complained to petitioner about slow delivery from Dobich had received their stock. (A. 80, 107.)

The Indiana Securities Commissioner received an additional 22 separate complaints about Dobich after November 30, 1964, including several which involved multiple purchases. Indeed, two of these complaints to the Commissioner were received from salesmen for Dobich who were finding it impossible to obtain delivery for their own customers. One listed 10 separate sales and another 12 separate sales of securities which had not yet been delivered. (A. 161-226, 310-17, 323.)

By the time of Dobich's death in July 1965 the Commissioner had received complaints of slow delivery by Dobich involving purchases by at least 69 different purchasers.

Despite this steady stream of complaints the Indiana Securities Commissioner failed to take any action other

than to inform Dobich of some of the complaints and request that he make delivery. (A. 718-49, 877-90.)

The only motive which the court could attribute to MULIC to explain why it could possibly want to aid and abet Dobich was that during some of the period in question petitioner was engaged in negotiations for mergers with other corporations and may have thought that Dobich's conduct would help the price of its shares to remain high. (App. B, 54-55, 72-73; App. C, 98-99.) It is undisputed that petitioner did not participate in any way in any of Dobich's securities transactions. Petitioner had no contact or communication, direct or indirect, with the persons in plaintiff's class, and received none of the money which Dobich obtained from them for the purchase of petitioner's stock. All of the sales were in the secondary market and involved only shares that were already issued and outstanding.

Nevertheless, petitioner was held liable to all persons who purchased its shares from Dobich after December 1, 1964. This liability is predicated on the District Court's theory that (a) Petitioner must have known of the fraudulent nature of Dobich's transactions by November 30, 1964; (b) MULIC's letters of November 30 constituted a "withdrawal" of its earlier threat to report Dobich directly to the Commissioner and a "signal" to Dobich that MULIC would not expose him, which thus aided, abetted or encouraged him; (c) petitioner had a legal duty to report Dobich to the Commissioner which it thus violated; (d) the failure to report was causally linked to the losses suffered by the plaintiff class because if such a report had been made the Indiana Commissioner would have put

Dobich out of business; and (e) the "signal" was causally linked to plaintiff's losses because without it Dobich would have voluntarily discontinued his fraud.[2]

It is the holding that MULIC had a legal duty to report what it purportedly knew of the activities of an independent securities broker to the Indiana Securities Commissioner that constitutes a significant and dangerous extension of the federal securities law worthy of review in this Court.

In addition, the conflict among the lower courts on basic questions of burden of proof and the handling of inferences in the ever expanding area of securities law and business fraud should be examined and resolved.

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[2] The undisputed evidence so clearly refutes this aspect of the causal connection issue that the majority opinion of the Court of Appeals drops this finding, thus leaving the causal relationship dependent on the proposition that, if MULIC had reported to the Commissioner on December 1, 1964, the nine complaints it had received, he would have investigated and discovered Dobich's insolvency, even in the face of the fact that the Commissioner had received 69 such complaints from Dobich's customers and salesmen without any investigation. (App. C, 100-01.)

REASONS FOR GRANTING THE WRIT

I.

THE HOLDING OF THE COURT OF APPEALS THAT A CORPORATION'S FAILURE TO REPORT STOCK PURCHASE AND SALES ACTIVITIES OF AN INDEPENDENT SECURITIES BROKER TO REGULATORY AGENCIES SUBJECTS IT TO LIABILITY TO ANYONE INJURED BY THE BROKERS MISCONDUCT IS A DANGEROUS AND UNWARRANTED EXTENSION OF SECTION 10(b) AND RULE 10b-5.

This case presents a novel and far reaching question under the Securities Exchange Act. The two to one majority opinion of the Court of Appeals holds, for the first time in any court, that a corporation has an affirmative duty to report to regulatory agencies the activities of an outsider dealing in its securities if it knows or should know that those activities may constitute a violation of the Securities Exchange Act. For breach of that "duty", the court imposes civil liability on the corporation to anyone injured by the broker's misconduct, even though his activities are totally independent of and beyond the direction or control of the corporation and utterly unconnected with any purchase or sale of securities by the corporation.[3]

The holding of the Court of Appeals not only carries corporate liability to investors beyond any reasonable read-

[3] The decision of the District Court affirmed by the Court of Appeals has been described as holding: "that an issuer of stock who has knowledge that its stock is involved in a transaction of such nature that section 10b and Rule 10b-5 are violated, has a duty to disclose this violation upon pain of civil liability." Note, 35 U.Mo. K.C.L. Rev. 320, 332 (1967) The note writer concluded that such a holding was clearly improper. See also A. Bromberg, *Securities Laws: Fraud—SEC Rule 10b-5*, Sec. 5.2, p. 95, n. 20 (1969).

Moreover, as discussed in Part II of this petition and in the dissenting opinion, the "knowledge" finding is at best the result

ing of Section 10(b) or Rule 10b-5, (the provisions relied on), and far beyond any previous decision, but subverts the spirit and intent of the Securities Exchange Act. As a practical matter the result in this case is to require the cautious investor to insure losses resulting from the negligence of incautious investors lured by the siren-song of a tipster-confidence man.

There is no doubt that Dobich, the broker-dealer, made many sales of MULIC stock in violation of Section 10(b) of the Act. It is undisputed, however, that petitioner was not a party to those transactions, received no portion of the proceeds and had no contact or communication, direct or indirect, with the plaintiff or any member of her class. There is no evidence that petitioner was informed of Dobich's sale to plaintiff or any member of the class except those few who complained and were advised to complain to the Commission.

The "knowledge" of Dobich's overall conduct which the Court attributed to MULIC was not in any sense "inside information." Indeed, it came to MULIC from the public in the form of inquiries about slow delivery, a complaint which was shared but never voiced by plaintiff. As the dissenting judge stated, "The only failing of which Midwestern is accused is failing to report each complaint of late delivery to the Commissioner. That it admittedly didn't do. Neither did the plaintiff. . . ." (App. C, 115.)

The Court of Appeals characterized the petitioner's failure to report Dobich as a form of "aiding and abetting

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of pyramiding strained inferences. Thus, the overall effect of the holding is to compel corporations to actively police the conduct of everyone dealing in the secondary market for their securities or run the risk of civil liability for an outsider's misconduct which some court finds, with hindsight, was or should have been known to the corporation.

cognizable under Section 10(b) and Rule 10b-5." (App. C, 101.) While the court also found what was styled "affirmative" conduct on the part of the petitioner in such aiding and abetting, the "affirmative" conduct referred to consisted *solely* of MULIC's letter of November 30, 1964, which purportedly "signaled" Dobich that petitioner did not intend to report the slow delivery complaints directly to the regulatory agencies. (App. C, 97-99.) It is obvious that unless there was a duty to report Dobich in the first instance, there can be no duty to carry out a threat to report.[4] Once again, the dissenting judge was clearly right in stating that "The only legal duty to make such a report of which we are told is a completely fictitious one supposedly created by Midwestern's own threat to do so. . . ." (App. C, 115.)

Thus, the issue squarely presented is whether Section 10(b) can be read to impose liability upon an issuer for failure to report irregular transactions in its shares. In phrasing liability in terms of a form of aiding and abetting *"cognizable under Section 10(b) and Rule 10b-5,"* the Court of Appeals recognizes that there is no such duty to report under general tort law.[5] Section 10(b) is invoked by implication, but on what inference? Clearly no such duty is imposed by the express terms of the Act or by any SEC

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[4] The Court of Appeals suggests that it is not deciding whether the failure to report "in itself" violated Rule 10b-5, but in finding a duty to report under Rule 10b-5 that is precisely what the Court has done.

[5] There is no general duty to prevent or to report the tortious act of another. 86 C.J.S. Torts § 33, p. 948. Nor is there a duty to report or prevent a crime. *Bratton* v. *United States*, 73 F.2d 795 (10th Cir. 1934); *Neal* v. *United States*, 102 F.2d 643 (8th Cir. 1939). See generally, Note 35 U.Mo. K.C.L. Rev. 322 (1967), discussing these doctrines at length in the context of this case. Failure to report a crime is not criminal "aiding and abetting." *Nye & Nissen* v. *United States*, 330 U.S. 613, 619 (1949); *Johnson* v. *United States*, 195 F.2d 673, 675-76 (8th Cir. 1952).

rule or regulation; neither has any court heretofore imposed such a duty under federal law. If there is such an obligation, it can only be founded upon an extension of the "spirit" or "intent" of the Securities Exchange Act.

We submit that an extension which goes so far beyond the language of the Act is beyond the proper powers of the judiciary and that, in any event, the extension proposed here does *not* follow the spirit or intent of the Securities Exchange Act. Rather, the split decision of the Court of Appeals if followed in other cases will result, as here, in gross inequities to innocent investors, the very persons whom the Act is intended to protect. A judgment against an issuer in favor of purchasers of its shares who because of broker fraud did not receive delivery of those shares is necessarily borne by the stockholders of the corporation. The rule adopted by the Court of Appeals—with the extent of liability turning on the volume of the issuer's shares purchased from an unscrupulous outsider—involves the risk of liability very large in proportion to the size of the issuer. Indeed the liability in this case could exceed 30% of petitioner's net worth. (A. 294, 328.) The result is to shift the loss of a group of negligent investors to those who were prudent and cautious.[6]

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[6] During the period while 419 persons in plaintiff's class, as defined in her complaint, were, unbeknown to plaintiff, purchasing stock from a fraudulent broker-dealer on the basis of a "tipster" sales approach, and while those persons were waiting month after month for delivery without complaint or investigation, other shareholders were purchasing and receiving over 190,000 shares of petitioner's stock from reputable brokers and dealers. (A. 229, 294.) Still others, who purchased from the fraudulent broker-dealer, made complaints to protect themselves and promptly received their stock. Another large group, of course, purchased their MULIC shares before Dobich ever started his activities. It is these persons who protected themselves by diligence in complaining of slow deliveries or by dealing with reputable brokers in the first instance who will ultimately pay the losses of those who failed to protect their own interests if this decision stands.

We submit that Judge Waterman was correct in asserting that the purpose of Rule 10b-5 is "to qualify, as between insiders and outsiders, the doctrine of *caveat emptor*—not to establish a scheme of investors' insurance." *List* v. *Fashion Park, Inc.*, 340 F.2d 457, 463, (2d Cir. 1965), *cert. denied sub nom. List* v. *Lerner*, 381 U.S. 811. See also Ruder, "*Texas Gulf Sulphur*—The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sale Cases" 63 Nw. U.L.R. 423, 443-44 (1969); Note, 82 Harv. L. R. 938, 949 (1969).

The sweeping extension of corporate liability for acts of outsiders which this case accomplishes has not passed unnoticed. The Assistant General Counsel of the SEC has declared that if the holding that MULIC's "silence" is actionable is followed by other courts, "substantial new obligations would be imposed upon the corporation in a variety of areas."[7]

Similarly, Professor Alan R. Bromberg calls the district court's decision "the farthest extension into this [non-disclosure liability] area." A. Bromberg *Securities Law: Fraud—SEC Rule 10b-5* Sec. 7.4(2) p. 166 n. 98 (1969).

The SEC itself has evidently refrained from asserting that non-disclosure is actionable under Rule 10b-5 in cases where the company is not trading in its own securities, even where internal corporate information is involved, much less the alleged knowledge of misconduct of an outsider which is involved here.[8]

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[7] Feuerstein, "The Corporation's Obligations When It Is Not Trading In Its Stock," *Obligations to Stockholders in Stockholder Litigation* (Ill. Inst. Cont. Legal ed. 1969), p. 28. The most significant of these, of course, will be the almost impossible task of screening and policing the conduct of the thousands of independent securities brokers around the country.

[8] Feuerstein, loc. cit., p. 20.

The decision in this case represents an unprecedented, unwarranted and unjust extension of the law which has the effect of penalizing innocent investors and thus contravenes the very purpose of securities regulation. Any such expansion should be left to Congress or should at least be predicated upon a rationale or principles set forth by this Court.

II.

THE RULES APPLIED BY LOWER COURTS IN ANALYZING AND REVIEWING IMPORTANT EVIDENTIARY QUESTIONS AND STANDARDS OF PROOF IN CASES INVOLVING THE EXPANDING CONCEPT OF CIVIL LIABILITY FOR SECURITIES ACT VIOLATIONS AND BUSINESS FRAUD ARE IN CONFLICT AND SHOULD BE CLARIFIED.

The opinions of the District Court and the majority of the Court of Appeals provide classic examples of the confusion which is prevalent among the lower courts in cases involving liability for aiding or conspiring to commit fraud.

Preoccupied with the novel questions of substantive law presented by the expansion of civil liability for business and financial misconduct, the courts have neglected to establish and maintain clear standards with respect to basic questions involving the burden of proof, the proper role of inferences and circumstantial evidence, and the standards of appellate review. Especially where a plaintiff attempts to impose liability upon a peripheral defendant on a conspiracy or aider and abetter theory in a complex business or securities fraud situation, the treatment of inference, circumstance, probability and speculation assumes major significance at both the trial and appellate level. The lower courts are in confusion and conflict on these issues and the time has come for this Court to provide guidance.

A.

Misplacing the Burden of Proof

If civil liability for the fraudulent conduct of others is to be imposed upon defendants whose offense consists of silence and inaction, and indeed whenever aiding and abetting or conspiracy is charged against persons on the fringe of a business fraud, one of the few protections which the defendant has is the requirement that the plaintiff bear the burden of proving the essential elements of his case by a preponderance of the evidence. Where a fraud has occurred it is inevitable that those affected will look to any solvent person who had the slightest connection with the affair as a potential source of recovery. Only if the requirement that the plaintiff prove the essential elements of his case is zealously protected can the defendant hope to avoid a decision based upon sympathy, suspicion or conjecture. Nevertheless it is in this expanding field of peripheral liability—where a clear concept of the burden of proof is most essential—that it has been most frequently ignored or obscured. The danger in loose judicial practices in the area of conspiracy law was pointed out by Mr. Justice Jackson in *Krulewitch* v. *United States,* 336 U.S. 440, 445, 452 (1949) (concurring), where he warned against lowering the requirements of proof to permit findings of guilt. See Goldstein, "The *Krulewitch* Warning: Guilt by Association," 54 Geo. L.J. 133 (1965). The opinions of both the District Court and the Court of Appeals provide classic examples of the evils which Justice Jackson perceived.

The District Court correctly held that an essential element of plaintiff's case is the existence of some proximate relationship between defendant's alleged inaction and plaintiff's injury. Nevertheless, supported only by a *dissenting*

opinion in *Baird* v. *Franklin*, 141 F.2d 238 (2nd Cir. 1944) *cert. den.* 323 U.S. 737, the district judge held that once the plaintiff adduced *some* evidence from which proximate cause could be inferred, *the burden was on defendant to disprove proximate cause by a preponderance of the evidence.* (App. B, 77-78.) This extraordinary ruling, which is contrary to unbroken authority that the plaintiff bears the burden of proof of proximate cause,[9] was raised on appeal but virtually ignored in the majority opinion.

B.

The Decision of the Court Below is Founded on a Novel Theory of Drawing and Compounding Inferences

Charges of aiding and abetting or conspiring to commit a complex business fraud frequently must be proved by inference and circumstance rather than direct evidence. Thus a problem which is encountered with peculiar frequency in peripheral liability cases is defining the evidentiary foundation required to support an inference. Another frequent question is when, if ever, it is proper to compound inferences.

This case involves clear examples of both the error of drawing inferences from speculation rather than evidence and the error of compounding or pyramiding inferences. *United States* v. *Ross*, 92 U.S. 281, 283-84 (1875). On these issues we refer the Court to the vigorous dissenting opin-

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[9] That the burden of proof of proximate cause in tort cases is on the plaintiff is hornbook law. Prosser, Torts p. 245 (3rd ed. 1964). The case which is perhaps closest on its facts is indeed the *Baird* case in which the majority correctly stated that the "[Plaintiffs] had the burden of showing that the breach of duty was the cause of their loss." (141 F.2d at 239.) Thus a conflict now exists between the Second and Seventh Circuits on this question.

ion of Judge Morgan which fully exposes the District Court's unsupported findings, particularly with respect to "knowledge" and "proximate cause". (App. C, pp. 103-115.) In view of the enormous growth of litigation in this area there is urgent need for this Court to set forth the circumstances in which a trial court may properly draw and compound inferences in cases of this type.

C.

The Decisions Are In Conflict as to the Proper Application of Rule 52(a) In Reviewing Inferences Drawn By The Trial Judge From Undisputed Facts

Most of the ultimate findings in this case were based on inferences drawn by the trial court from basic facts which were either undisputed or determined and stated by the trial court.[10] There is great confusion among the Circuits with respect to their role in reviewing inferences drawn by a trial judge. For many years there was a split among the circuits on whether Rule 52(a) applied to inferences drawn by a trial judge at all, and if so, the weight to be afforded such inferences. Compare, for example, *National Latex Products Co.* v. *Sun Rubber Co.*, 274 F.2d 224, 247 (6th Cir. 1960), *cert. denied* 362 U.S. 989; *E. H. Sheldon & Co.* v. *Commissioner*, 214 F.2d 655, 658-59 (6th Cir. 1954); *Stubbs* v. *Fulton National Bank of Atlanta*, 146 F.2d 558, 560 (5th Cir. 1945), *cert. denied* 325 U.S. 864; *Sears, Roebuck & Co.* v. *Johnson*, 219 F.2d 590, 591 (3rd Cir. 1955) (all holding, in effect, that the Court of Appeals is free to draw its own inferences from established facts), with *Orvis* v. *Higgins*, 180 F.2d 537, 539 (2nd Cir. 1950), *cert. denied* 340 U.S. 810; *American*

[10] The Court of Appeals states that a determination of credibility necessarily played some part in the trial court's findings. Petitioner, however, does not challenge any of the trial court's findings on credibility or disputed evidence.

Tobacco Co. v. *The Katingo Hadjipatera,* 194 F.2d 449, 451 (2nd Cir. 1951), *cert. denied* 343 U.S. 978 (1952); *Kuhn* v. *Princess Lida of Thurn and Taxis,* 119 F.2d 704, 705-06 (3rd Cir. 1941); 5 Moore's Federal Practice ¶52.04 (1969 ed.) (all stating that while Rule 52(a) is applicable the standards of review are more liberal where for one reason or another questions of credibility are not involved), and *Hill* v. *Gregory,* 241 F.2d 612, 614 (7th Cir. 1957), *cert. denied* 354 U.S. 938; *McDermott* v. *John Baumgarth Company,* 286 F.2d 864, 868 (7th Cir. 1961); *Randall Foundation Inc.* v. *Riddell,* 244 F.2d 803, 805 (9th Cir. 1957) (supporting the view adopted by the Court of Appeals that inferences drawn from undisputed facts are to be treated like any other findings of fact).

In *United States* v. *United States Gypsum Co.,* 333 U.S. 364, (1944), this Court suggested distinctions between the applications of Rule 52(a) to findings based on a resolution of disputed evidence and those based on documents or undisputed facts and pointed out the difference in the weight to be accorded the findings of a trial judge as compared to those of a jury. In *Commissioner of Internal Revenue* v. *Duberstein,* 363 U.S. 278 (1960), the Court held that primary inferences drawn from undisputed facts are subject to the "clearly erroneous" test of Rule 52(a). The issue there was whether a transfer of property was a "gift" or a payment for services.

While *Duberstein* dispelled the contention that a reviewing court may ignore the inferences drawn by a trial judge from undisputed facts, it has not resolved the confusion with respect to the proper application of Rule 52(a) in many circumstances. Thus, while *U.S. Gypsum* was cited with approval in *Duberstein,* some circuits seem to hold that *Duberstein* has eliminated any distinction between findings based on the resolution of disputed testi-

mony and inferences drawn from undisputed facts despite the express language of Rule 52(a) which requires consideration of the extent to which the credibility of witnesses is involved. Such is the import of the holding here. Other circuits, however, have continued to recognize the distinction between various types of inferences. *Armour and Company* v. *Celic,* 294 F.2d 432, 437 (2nd Cir. 1961). Whether *Duberstein* is intended to hold that Rule 52(a) applies with as much force to inferences drawn from undisputed evidence as to issues of credibility is unresolved. Compare *Maryland* v. *U.S.,* 329 F.2d 722, 723 (3rd Cir. 1964), *affirmed* 381 U.S. 41 (1965), with *Lundgren* v. *Freeman,* 307 F.2d 104, 113-15 (9th Cir. 1962).

The distinction drawn in *Armour & Company* between the weight to be afforded primary inferences as compared to secondary or derivative inferences is directly applicable to this case. Here, several of the trial court's crucial findings are secondary inferences derived from other inferences.

In addition the Court of Appeals confuses the standards of review applicable to the findings of a trial judge with those applicable to the findings of a jury. In defining the scope of its review of the trial court's inferences, the majority opinion states (App. C, 89):

> "Our function is to ascertain, after considering the record in its entirety, whether the inferences drawn by the trial judge have a sufficient evidentiary basis so that it can be said they are reasonable, that is, *could* have been arrived at by logical deduction." (Emphasis supplied.)

The rule stated is that which applies to jury verdicts and is wholly inapplicable to the review of findings of a trial judge under Rule 52(a). *Orvis* v. *Higgins,* 180 F.2d

537 at 539 (2nd Cir. 1950); cf. *United States* v. *United States Gypsum, supra,* at 395.

As the limits of civil liability are extended, so with increasing frequency crucial issues are determined by inference rather than direct evidence. The administration of justice requires that the standards of appellate review of primary and derivative inferences be clarified.

CONCLUSION

The decision of the Court of Appeals for the Seventh Circuit extends the civil liability of corporations under Section 10(b) and Rule 10b-5 significantly beyond any previous case. It will make corporations and their investors virtually insurers against the misconduct of outsiders dealing in the secondary market in the company's securities. That decision, with its far reaching consequences, should be reviewed by this Court.

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IN THE

Supreme Court of The United States

OCTOBER TERM, 1969

No. 1143

MIDWESTERN UNITED LIFE INSURANCE COMPANY,

Petitioner,

vs.

TORA C. BRENNAN,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

Opinions Below

The Petition for Certiorari is directed to a judgment of the United States Court of Appeals for the Seventh Circuit, affirming a judgment of the United States District Court for the Northern District of Indiana. The Respondent, Mrs. Tora C. Brennan, filed a class action alleging that the

Petitioner (hereinafter "MULIC") aided and abetted Dobich Securities Corporation (hereinafter "Dobich Securities") in violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78j(b), and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. Sec. 240. 10b-5.

The District Court found for the Respondent, in a memorandum opinion that contains detailed findings of fact and conclusions of law. 286 F. Supp. 702 (1968) (App. 25-86). The United States Court of Appeals for the Seventh Circuit affirmed the judgment of the District Court. 417 F. 2d 147 (1969) (App. 87-115).

Jurisdiction

The Petitioner is invoking the jurisdiction of this Court under 28 U.S.C. Sec. 1254(1). As set forth in Rule 19 of the Supreme Court of the United States, "A review on Writ of Certiorari is not a matter of right, but of sound judicial discretion, and will be granted only where there are special and important reasons therefor."

Questions Presented

1. Do Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission impose a duty upon a corporation whose stock is held by public investors to refrain from aiding and abetting a broker who is known to be engaged in fraudulent practices, for the purpose of gaining a benefit for itself?

2. Did the Court of Appeals err in concluding that there was ample evidence that the corporation facilitated the broker's fraud, that the findings of the District Court were not clearly erroneous, and in applying the "clearly erroneous" test to those findings?

Statute and Rules Involved

The pertinent provisions of the Securities Exchange Act of 1934, Rule 10b-5 of the SEC, and Rule 52 of the Federal Rules of Civil Procedure are set forth in the Petition at Pages 3 and 4.

STATEMENT OF THE CASE

This case began in November of 1965 when Tora C. Brennan brought a class action for damages against MULIC. The Plaintiff contended that she and the members of the class had been defrauded by Dobich Securities, a brokerage firm engaged in a fraudulent course of conduct in violation of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission. The Plaintiff also contended that MULIC had aided and abetted the fraud for the purpose of gaining a benefit for itself and its officers and directors. (A. 5*)

Dobich Securities and its 26 commission salesmen sold only MULIC stock from June of 1964 until July of 1965. The salesmen went from door to door and from farmhouse to farmhouse in Indiana selling MULIC stock the way others sell brushes. (A. 292-93)

The firm was insolvent during this entire period, and engaged in short sales of MULIC stock by selling shares which it did not own or have the ability to purchase. Monies paid Dobich Securities for the purchase of MULIC stock were used for stock and commodity speculations, for office expenses and for covering prior short sales. In short, Dobich Securities robbed Peter to pay Paul. (A. 375, 377)

Between May of 1964 and July of 1965 Dobich Securities delivered 48,409 shares of MULIC stock. During the same period and before the firm filed a voluntary petition in bankruptcy, Dobich Securities customers paid approxi-

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* "A. —" refers to the appendix filed in the Court of Appeals. "App. —" refers to the appendix filed in this Court with the petition. "R. —" refers to the record on appeal.

mately $2,900,000.00 for 36,000 shares of MULIC stock which will never be delivered. (A. 294)

MULIC is a publicly held corporation. During the period pertinent to this action, it had 1,000,000 shares of stock outstanding (A. 561) and over 10,000 stockholders. (A. 630) Some of its stock was registered with the SEC. (A. 64) Its stock was quoted daily in the Wall Street Journal and other financial publications, and traded on the over-the-counter market.

MULIC's petition does not comply with Rule 40(1)(e) of this Court in that its Statement of the Case does not contain "all that is material to the consideration of the questions presented." The following is a summary of the evidence on which the District Court and the Court of Appeals held MULIC had aided and abetted the Dobich Securities violation of § 10(b) and Rule 10b-5, and which MULIC's Petition fails to disclose.

Events Preceding the MULIC Decision to Aid and Abet Dobich Securities

Philip Schwanz, MULIC's president, and Ralph Sheets, MULIC's counsel and assistant secretary, were the officers of MULIC who caused the company to aid and abet Dobich Securities. In May of 1964 they learned that Dobich Securities intended to sell MULIC stock on an exclusive basis and was predicting the price of MULIC stock would go from $65.00 to $135.00 per share within six months. They also learned that Dobich Securities was using false rumors of a merger as part of its sales technique. (A. 72)

It was while acting as its own transfer agent and registrar that MULIC obtained knowledge of the nature and extent of the activities of Dobich Securities. During August

and September of 1964 MULIC received complaints or what Schwanz and Sheets considered "quite a number of occasions" from persons who had not received delivery of MULIC stock purchased from Dobich Securities for periods ranging from six weeks to four months. The amounts involved ranged from $2,000 to $50,000. (A. 82-87)

Schwanz and Sheets knew something was amiss and wrote a letter on September 28, 1964, to Michael Dobich, the president of Dobich Securities, in which they said, "*It appears that you are using your clients' money as working capital, which should not be done.*" The letter threatened to report Dobich Securities to the Indiana Securities Commission if any future complaints of non-delivery came to MULIC's attention, and concluded by expressing concern for its solvency:

> "Mike, we do not want to cause you any trouble; but if, for some reason, your firm should be unable to make good on its obligations to transfer MULIC stock after your clients have paid for it, they might feel that MULIC is somehow responsible. We do not want this to happen.
>
> If there is some reasonable explanation for these delays, please let us know." (A. 90)

Dobich responded on October 2, by writing Schwanz and Sheets that Dobich Securities had developed a "substantial interest" in MULIC stock and requesting a meeting with them. Then on October 6 Schwanz and Sheets learned of another complaint of non-delivery, involving $7500 paid by the investor some three months earlier, and they again wrote Dobich asking for an explanation. (A. 91-94)

Dobich, Schwanz and Sheets met at MULIC's home office in Fort Wayne, Indiana on October 12, 1964. Dobich was killed before Plaintiff brought this action and could tell

no tales. The tale Schwanz and Sheets told was that Dobich said he was not "short in his accounts," he always had stock to cover his sales but the bank which held the stock as collateral and other brokers were slow in getting it to him, and he was pushing the sale of MULIC stock. (A. 473, 578-79)

Schwanz and Sheets testified they believed everything Dobich said *except* that he was selling a lot of MULIC stock! Nevertheless, they agreed to give him two weeks "to get even with the board," and confirmed the agreement in a letter dated October 13 in which they stated MULIC would refer any complaints of non-delivery received after the two week period to the Indiana Securities Commission "for suitable investigation." (A. 95, 477-78, 580-81, 638)

On October 15 Schwanz and Sheets knew to a certainty Dobich had lied to them and that Dobich Securities was making misrepresentations to its customers to excuse its consistent failure to deliver MULIC stock within a reasonable time. One such customer reported that day he had been told he wouldn't get his stock for "a while" because Dobich Securities "did not want to flood the market" with MULIC stock. (A. 99) Another customer reported he was told "the stock was in inventory and any delay in its delivery would be the fault of MULIC." (A. 98)

These representations were false and Schwanz and Sheets knew it. They admitted they knew that Dobich Securities could hardly "flood the market" by presenting

shares for transfer and that MULIC was not responsible for the delay in delivery. (A. 482, 585-86)

A third person who complained that same day that he had paid an *unnamed* broker four months before for undelivered MULIC stock was advised by MULIC to contact his broker; MULIC sent Michael Dobich a blind carbon copy of MULIC's letter to the complaining customer even though the customer had not identified the broker involved. (A. 96-97) The fact was that Dobich Securities was the broker involved, and MULIC knew it, because MULIC *never* received such complaints about any other broker. (A. 404)

The blind carbon copy, of course, served two purposes. It confirmed MULIC's agreement to give Dobich Securities two weeks to "get even with the board" and it kept the complaining customer from knowing that he was the subject of a MULIC-Dobich Securities cooperative effort.

The Effect of the Activities of Dobich Securities on the Price of MULIC Stock

Dobich Securities did not sell MULIC stock prior to June of 1964. (A. 292) Thereafter Schwanz observed that Dobich Securities was "doing a better job than any other Indiana broker." (A. 612) In point of fact Dobich Securities sold more MULIC stock than any other broker in the United States, and only Merrill Lynch delivered more. (A. 299) The following shows the extent to which the price of MULIC stock increased in 1964 when Dobich Securities

went into the market to cover some short sales. (R. 525-726, A. 331)

Month	MULIC Shares Presented For Transfer by Dobich Securities	MULIC Shares Presented For Transfer by All Others	High Bid Price Per Share	Low Bid Price Per Share
May, 1964	-0-	13,941	—	—
June	478	18,307	$69.00	$65.00
July	2,725	13,965	81.00	69.40
August	884	12,944	79.00	75.00
September	3,381	15,217	81.40	79.00
October	4,515	13,341	89.00	80.00
November	5,549	19,494	90.00	86.00
December	4,671	14,760	93.00	87.00
January, 1965	4,099	6,192	91.40	86.00

There was ample evidence that there was a thin market for MULIC stock and that Dobich Securities caused the market to go up when it covered short sales. Several brokers who made a market in MULIC stock, including one who furnished daily quotations for the Wall Street Journal, so testified. MULIC earned 30¢ per share in 1964. This was considerably less than the company had earned in 1963. When Dobich Securities drove the price up to $90.00 per share, the stock was selling at 300 times earnings! (A. 290-292, 597, 680-90)

Schwanz has admitted he knew that Dobich Securities was inflating the price of MULIC stock when the firm went into the market to cover some of its short sales. He also testified that a corporation is in a better position to negotiate mergers when its stock increases in price, and he wasted no time negotiating one. (A. 605, 608, 635)

The two-week period MULIC gave Dobich to get "even with the board" had ended by October 28, 1964. On that

date Schwanz negotiated an agreement for the merger of Illinois Mid-Continent Life Insurance Company (hereinafter "IMC") into MULIC. The agreement provided that IMC shareholders would receive one share of MULIC stock in exchange for ten shares of IMC. (A. 249)

The 10-for-1 exchange ratio was based primarily on prevailing market prices. The IMC stock was being quoted at $9.50 per share and MULIC at $88.00. The adjusted book values of the two corporations supported ratios ranging from 4.59-to-1 to 5.87-to-1, depending upon the calculation method used. (A. 247-58, 269, 599)

The proposed merger was vigorously contested in the courts by the IMC shareholders promptly after it was announced. They filed suit on November 10, and a bitter and lengthy proxy fight ensued. MULIC relied exclusively on the market prices of the stocks in its efforts to defend the propriety of the merger. The IMC stockholders were told, "The adjusted book value of the shares has little relationship to the value of the shares in that the value of the shares is primarily established by the market value in over-the-counter trading." The IMC shareholders, however, did not believe that the prevailing market price of MULIC stock truly reflected its value and on February 4, 1965, voted the merger down. (A. 251, 259-74, 285, R. 1013)

Schwanz admitted that it would have been embarrassing for MULIC if the SEC or the Indiana Securities Commission had investigated Dobich while the proxy fight was in progress. (A. 645-646) He also admitted that if Dobich Securities had been put out of business in November or December of 1964, there could have been a serious decline in the price of MULIC stock. (A. 646)

Such a decline, of course, would have deprived MULIC of its sole merger selling point with the IMC shareholders.

It would have deprived MULIC of a merger selling point with the shareholders of Great Northern Life Insurance Company for a merger which was proposed shortly after the IMC merger fell through, and which was consummated after Dobich was killed. It would also have deprived the MULIC insiders of the substantial profits they made upon selling over $500,000.00 worth of MULIC stock. (A. 236-37, 626, 777, 812, 820)

MULIC Begins Aiding and Abetting Dobich Securities to Maintain the Inflated Price for Its Stock

In late November of 1964, while the proxy battle was being fought, MULIC learned that Dobich Securities was not going to keep its part of the October 12 bargain. MULIC received two more complaints of non-delivery and was called upon to make a very important decision concerning Dobich Securities. (A. 106, 587-89, 665-72)

MULIC had assured Dobich that it would refer one more such complaint to the Indiana Securities Commission. However, the proxy fight and MULIC's need to maintain the inflated price for its stock produced a change of heart.

When Robert E. Dillon notified a MULIC agent on November 23, that he had purchased $16,400 worth of stock on September 10, and had failed to receive delivery, Schwanz and Sheets changed their course completely. (A. 666-672) By letter of November 30, they notified Dobich of the complaint and that the customer was being advised to contact his attorney or the Commission in the event that Dobich Securities didn't come up with the customer's stock or an explanation for non-delivery. Schwanz and Sheets knew the sort of explanation Dobich gave his customers. (A. 104-05)

The second complainant, Frederick E. Volkee, was given the same letter advice on December 1, and Dobich was alerted to the complainant's identity by means of a blind carbon copy of the letter. (A. 106-07)

Schwanz admitted that the adoption of this procedure for dealing with complaints from Dobich customers created an avenue for Dobich whereby he could make delivery to persons who were likely to cause him trouble and thereby avoid trouble. (A. 596) Dobich got the message that MULIC was not only no longer a threat to him but was going to keep him in business by identifying those customers sophisticated enough to complain. He promptly delivered shares to MULIC for transfer to the two complainants. Therefore until shortly before his death Dobich delivered shares to MULIC for transfer to others who contacted MULIC and were referred back to him. (A. 80-81)

Schwanz and Sheets never wavered from their decision to help Dobich. From and after November of 1964 until the day Dobich crashed his helicopter in July of 1965, MULIC acted as a lookout and systematically referred complaining Dobich customers back to Dobich so that Dobich could make delivery, stay in business and continue to keep the price of MULIC stock at artificially high levels. (A. 101-160) As late as June 29, 1965, Sheets told one farmer's wife to "threaten to prosecute but not go through with it." (A. 703)

Schwanz and Sheets, of course, did not wish to publicize the MULIC-Dobich relationship. Blind carbon copies were used on some occasions. On another, when Schwanz and his associates were laughing about the fact that Dobich had inflated the price of MULIC's stock by flying around in his helicopter and selling it to the farmers, Schwanz falsely stated that he had never met Dobich. (A. 683-84)

The Calculated Risk

MULIC decided to aid and abet the Dobich Securities fraud because it was to MULIC's advantage to do so, and because Schwanz and Sheets didn't think the risk of harm to MULIC was great. Schwanz testified that he calculated MULIC's exposure was no more than 1000-1500 shares in the event Dobich Securities went into bankruptcy, "and that could be cleared up very easily." (A. 611-13) Schwanz erred. After Dobich's death Schwanz told a caller, "I've considered shutting him off and not letting him operate", and "If the guy had lived, he might have pulled it off." (A. 873-74)

This case, contrary to MULIC's Statement of the Issues Presented (Pet. p. 2), clearly involves neither a corporation which had "no connection or relationship with the broker," nor one that was held liable solely for a failure to report the broker's activities to the SEC or a state regulatory commission.

The Trial Court held that MULIC was liable as an aider and abettor for acting as a lookout for Dobich. The trial court also stated:

> ". . . it has not been necessary to the holding of the court to decide whether mere 'silence and inaction' under the unusual circumstances of this case constituted aiding and abetting which caused the alleged damages. However, since under the evidence and the law the defendant's failure to report [to the regulatory agencies] would constitute an independent basis of recovery and the parties have extensively briefed this question, it has been given consideration in this opinion." (App. 27)

The Trial Court held in the alternative that MULIC was liable under the facts and circumstances of this case for

failing to report Dobich's activities to the SEC or the Indiana Securities Commission. (App. 99)

The Court of Appeals held that MULIC was liable as an aider and abettor for its affirmative wrongdoing in acting as Dobich's lookout and for its purposeful silence. The court felt it unnecessary to decide whether MULIC could be held liable for a failure to report if its silence had not been for the purpose of obtaining and maintaining an artificial buildup in the market for its stock, and had not been accompanied by its affirmative misconduct:

> "It is our view that the district court was correct in concluding that Midwestern's acquiescence through silence in the fraudulent conduct of Dobich *combined with its affirmative acts* was a form of aiding and abetting cognizable under Section 10(b) and Rule 10b-5 . . . . Without deciding whether the failure to report Dobich's activities to the Indiana Securities Commission would *in itself* give rise to liability under Rule 10b-5, we find that under all the facts and circumstances of this case, Midwestern's actions amounted to a tacit agreement with Dobich to prevent complaints from reaching the Commission, thus facilitating the fraud and allowing Dobich's scheme to continue to Midwestern's benefit." (App. 101-02) (Emphasis added.)

The Court, in addition, made no error with respect to the burden of proof, had ample support in the record for its decision, and applied the proper standard of review.

ARGUMENT

REASONS FOR DENYING THE WRIT

I.

The Case Presents No Novel or Far Reaching Questions

The decision of the Court of Appeals presents no questions for review by this Court. MULIC has therefore concocted questions for review which ignore the decision of the Court of Appeals and the facts of this case.

The Court of Appeals did not hold MULIC liable solely for a failure to report its knowledge of Dobich's activities to regulatory agencies, as MULIC tells this Court. (Pet. p. 11) The Court of Appeals held that MULIC's affirmative conduct in acting as a lookout for Dobich, combined with MULIC's calculated silence and its purpose to gain a benefit for itself rendered MULIC liable as an aider and abettor. (App. 101-02)

The Court properly refrained from deciding whether MULIC could be liable if its failure to report were isolated from all of the other unique facts and circumstances of this case. It is clear beyond dispute that MULIC's affirmative conduct, without regard to its failure to report, renders it liable here as an aider and abettor.

MULIC's assertion that it had no knowledge Dobich was defrauding his customers is in conflict with the evidence, to say the least. MULIC had complete knowledge by October 15, 1964.

MULIC knew that Dobich was wrongfully using his customers' money as working capital. MULIC knew that

Dobich Securities was "unable to make good on its obligations to transfer MULIC stock" to customers who had paid for it months before. MULIC knew that Dobich was making flagrantly false representations to excuse his inability to deliver. MULIC knew that the "substantial interest" Dobich Securities was creating in its stock put MULIC in an unusually good merger position and allowed its insiders to sell at inflated prices.

MULIC chose to help Dobich from November of 1964 until July of 1965 in order to maintain its Dobich-created merger position and insider profits. MULIC identified for Dobich potential troublemakers whose stock should be delivered. MULIC kept those persons away from the SEC and the Indiana Securities Commission. MULIC helped Dobich conceal the fraud.

Such conduct has always rendered one an aider and abettor and liable as a principal. 22 C.J.S., *Criminal Law*, § 86(b), 88(2); 86 C.J.S., *Torts*, §33. And Congress, of course, has granted aiders and abettors no immunity from liability under the Securities Laws. *Carroll v. First National Bank of Lincolnwood*, 413 F.2d 353, 357 (7th Cir. 1969) cert.den. 1-12-70, Dkt. 651; *Buttrey v. Merrill Lynch Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir. 1969) cert.den. 10-13-69 Dkt. 341; *Anderson v. Francis I. duPont & Co.*, 291 F.Supp. 705, 709 (D. Minn. 1968); *Fischer v. Kletz*, 266 F.Supp. 180, 190 S.D.N.Y. 1967); *Ross v. Licht*, 263 F.Supp. 395, 410 (S.D. N.Y. 1967); *Pettit v. American Stock Exchange*, 217 F.Supp. 21, 28 (S.D.N.Y. 1963); *SEC v. Scott Taylor & Co.*, 183 F.Supp. 904 (S.D.N.Y. 1959); *Hawkins v. Merrill Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104, 121 (W.D.Ark. 1949); *SEC v. Timetrust, Inc.*, 28 F.Supp. 34, 43 (N.D.Cal. 1939) app. dismd. 118 F.2d 718 (9th Cir. 1941).

The effectiveness of MULIC's aiding and abetting is demonstrated by the fact that not one complaint reached the SEC about Dobich until the day before he died, only one person of the many who contacted MULIC subsequently contacted the Indiana Securities Commission, and not one customer lawsuit was filed against Dobich before he died. (A. 213, 324)

It should also be noted that contrary to its assertions, MULIC's liability is nowhere near 30% of its net worth.* The sum necessary to satisfy the judgment has long since been set aside by MULIC, and counsel have stipulated the validity of the great majority of the class members' claims. In addition, we are confident that the loss here will be borne by Schwanz, Sheets and other MULIC insiders who took a calculated risk in helping Dobich. The innocent MULIC shareholders about whom such concern is now expressed (Pet. p. 14) will no doubt feel that their corporation is entitled to indemnity.

There is nothing novel or far reaching in the decision of the Court of Appeals. The case below clearly turned on its unusual facts and not upon any unsettled principles of law. This Court, of course, does not grant a writ of certiorari to review such a case. *United States v. Johnston*, 268 U.S. 220, 227 (1925).

*** The value of an insurance company is determined by many formulas; MULIC's statutory net worth of $6,000,000 in November 1964, was translated into book value of from $17,000,000 to $23,000,000, and blown up to $90,000,000 of alleged market value for purposes of the IMC merger. (A. 257-258, 595)**

II.

THE DECISION OF THE COURT BELOW IS CLEARLY CORRECT AND THE REMAINING POINTS RAISED BY THE PETITION PRESENT NO QUESTIONS FOR REVIEW

The petition provides a classic example of the lengths to which a twice defeated party will go to seek a third hearing. MULIC has already had two full and fair hearings. Preoccupied with its desire to avoid liability for the wrongdoing of its insiders, MULIC has neglected the facts of this case and the law applicable thereto.

A.

The Burden of Proof was Properly Placed

The District Court applied the "but for" standard of causation and held that Plaintiff had met her burden of proof. MULIC sought to apportion the harm between itself and Dobich and the Court placed the burden of apportionment upon MULIC in accordance with Restatement, *Torts 2d*, § 433B, *Davis v. Garrett*, 6 Bing. 716, 724, 130 Eng. Reps. 1456, 1459 (C.P. 1830) and Judge Clark's opinion in *Baird v. Franklin*, 141 F.2d 238 (2nd Cir. 1944) cert.den. 323 U.S. 737 (1944).

Mrs. Brennan clearly met the burden that would have been imposed upon her if this were a negligence action. However, she was not required to prove that "but for" the aider and abettor's conduct the harm would not have occurred. The Plaintiff was only required to prove that the conduct of MULIC facilitated Dobich's wrongdoing. 22 C.J.S., *Criminal Law*, § 88, p. 264, 15A C.J.S., *Conspiracy*, § 18, p. 658; and the opinion of the Court of Appeals so holds. (App. 100, 102)

The trial court's application of the more stringent "but for" standard of causation, of course, did not require that the Court of Appeals disturb the judgment on appeal. *Brown v. Allen*, 344 U.S. 443, 459 (1953); *SEC. v. Chenery Corp.*, 318 U.S. 80, 88 (1943); *Riley Investment Company v. Commissioner*, 311 U.S. 55, 59 (1940).

The Courts below properly found that the acts of MULIC were the legal cause of the loss suffered by Respondent and other members of her class. It is clear under the facts of this case that MULIC facilitated the Dobich fraud. MULIC's conduct was therefore a proximate cause of the loss.

A similar question of proximate cause was raised in the case of *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F. 2d 135 (7th Cir. 1969) *cert. den.* 10-13-69 Dkt. 341. In that case, which is almost a companion to this one, it was alleged that Merrill Lynch violated Rule 405 of the New York Stock Exchange in permitting Dobich Securities to operate on a speculative basis without furnishing financial statements or bank references or credit reports as the Rule required. One of the issues on appeal, when a motion for summary judgment was denied, was the contention by Merrill Lynch that its alleged violation of Rule 405 did not proximately cause the losses incurred by Dobich. The Court of Appeals held that the result of Merrill Lynch's disregard of Rule 405 was to permit Dobich to use the Merrill Lynch facilities to speculate with funds converted from his customers. The Court said, ". . . the conduct of the defendants in permitting the use of the account and in failing to properly supervise it paved the way for the losses suffered by these plaintiffs." See 410 F.2d at 143 (7th Cir. 1969) *cert. den.* 10-13-69, Dkt. 341.

Similarly MULIC paved the way for Dobich to stay in business and facilitated the fraud. MULIC helped Dobich by identifying the complaining customers. MULIC helped him conceal his fraud by heading off complaints that would have reached the authorities. MULIC helped him enable the squeaky wheel to get the grease (A. 559, 648). In other words, MULIC acted as the lookout, while the continuing series of robberies took place.

B.

The Decision Below is Based Upon Substantial Evidence

The evidence upon which the District Court based its findings is set forth in the Court's exhaustive Memorandum of Decision (App. 25-86). The evidence of MULIC's knowing participation in the Dobich fraud is overwhelming.

No one can recreate the full flavor of a trial of a case. The printed page does not convey the facial expressions of the witnesses, the inflections in their voices, the varying speeds of their speech, the pauses in their answers.

The trial judge saw and heard the witnesses. He had to judge their credibility. He examined the documents and heard what the witnesses said about them. His findings of fact and the inferences he drew from the evidence were properly given great weight by the Court of Appeals.

C.

The Trial Court Drew No Crucial Inferences from Undisputed Facts

The fact that some Courts of Appeal have held that Rule 52(a) does not apply where the evidence before the

District Court was undisputed is wholly irrelevant here. The evidence in this case was hardly undisputed.

The MULIC insiders told one story during the lengthy trial of this case, while other witnesses told another. The meaning of the documents from MULIC's files was sharply disputed, and the insiders were questioned at length about them.

The Trial Judge was required to determine whether Schwanz and Sheets were fools or knaves. He was also required to determine from conflicting evidence knowledge, motive, design, and the intent with which men acted. Such findings depend particularly upon the trial court's credibility appraisals. *United States v. Oregon State Medical Society,* 343 U.S. 326, 331-332 (1952); *United States v. Yellow Cab Company,* 338 U.S. 338, 341 (1949).

MULIC's statement (Pet. p. 19) that it does not challenge any findings on credibility or disputed evidence is simply incredible. All of the findings essential to a judgment for the Plaintiff, including the finding that MULIC knowingly participated in the Dobich fraud, were based upon evaluations of credibility and disputed evidence. (App. 25-86) Petitioner's statement of the case clearly challenges those findings.

Finally, MULIC's assertion that the Court of Appeals applied the standard of review applicable to jury verdicts is clearly without merit. The Court properly concluded that there was substantial evidence in the Record to support the findings of the trial judge and that those findings were not clearly erroneous. (App. 88-90) *United States v. United States Gypsum Co.,* 333 U.S. 364, 394-95 (1948); *United States v. Yellow Cab Co.,* 338 U.S. 338, 341-42 (1949); *United States v. Oregon State Medical Society.* 343 U.S. 326, 331-332 (1952).

CONCLUSION

This Court does not issue a Writ of Certiorari to give a twice-defeated party a third opportunity to argue either the sufficiency of evidence or abstract points of law that have no relation to the evidence. *Magnum Import Co. v. Coty*, 262 U.S. 159, 163 (1923), *The Monrosa v. Carbon Black Export, Inc.*, 359 U.S. 180 (1959).

The Writ should be denied.

Respectfully submitted,

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No. 1143

In the Supreme Court of the United States

OCTOBER TERM, 1969

MIDWESTERN UNITED LIFE INSURANCE COMPANY,
Petitioner,

vs.

TORA C. BRENNAN,
Respondent.

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Petitioner Midwestern United Life Insurance Company (MULIC), pursuant to Rule 24(4) of the Court, replies to respondent's brief in opposition to the petition for Writ of Certiorari as follows:

1. Respondent's brief is largely devoted to a restatement of the facts, apparently designed to persuade the Court that the decision below was equitable, regardless of the resolution of the questions presented in MULIC's petition. Respondent's statement of facts is highly argumentative, misleading and in some instances grossly in-

accurate. None of the basic questions presented in this case, however, require the resolution of factual disputes. The errors complained of are apparent on the face of the opinions of the District Court and the Court of Appeals.

2. Respondent asserts that this case does not present the question of whether Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 of the Securities and Exchange Commission imposes a duty upon corporations to report irregularities in the conduct of independent securities brokers to the state or Federal regulatory agencies. In support of that contention respondent points out that in reaching its decision the Court of Appeals referred to matters in addition to MULIC's failure to report.

Petitioner accurately described the basis for the decision of the majority of the Court of Appeals in its Petition for Writ of Certiorari (p. 13).

Respondent fails to recognize that to say that the decision of the Court below was not based *solely* upon MULIC's failure to report is not to say that the decision does not present the question of whether Section 10(b) or Rule 10b-5 create a duty to report. The Court of Appeals clearly held that petitioner had a duty to report the misconduct of an independent securities broker to the regulatory agencies and that its failure to make such a report constituted a form of aiding and abetting "cognizable under Section 10(b) and Rule 10b-5" which gave rise to liability to persons purchasing securities from the independent broker.

While the failure to report was not the only factor considered by the Court below, it was clearly an essential element in the finding of liability. Indeed, the only causal connection which the Court of Appeals finds between petitioner's conduct and respondent's injury relates ex-

clusively to the failure to report. The Court held that if MULIC had reported Dobich's misconduct to the regulatory agencies, the agencies would have ended Dobich's activities and thus avoided the injuries suffered by persons who purchased securities from Dobich after December 1, 1964. The logic of the Court of Appeals' decision imposing liability on MULIC to persons who purchased securities from Dobich on and after December 1, 1964, is dependent upon the proposition that by that date MULIC had sufficient information about Dobich's conduct to trigger a duty to report which MULIC breached.[1] Thus in the absence of a duty to report cognizable under Section 10(b) and Rule 10b-5, there can be no liability to respondent on the part of MULIC. The novel and far-reaching question raised in Part I of MULIC's Petition for Writ of Certiorari is directly presented by the decision in this case and should be resolved by this Court.[2]

3. Contrary to the contention in respondent's brief, the questions presented in Part II of the Petition for Writ of Certiorari are apparent on the face of the majority opinion of the Court of Appeals for the Seventh Circuit. Respondent apparently concedes that shifting the burden of proof of causal connection to the defendant was improper and tries to avoid the consequences of this error by suggesting that it was unnecessary for respondent to show a causal connection under the traditional "but for"

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[1] The Court of Appeals did not adopt the alternate theory that Dobich would have voluntarily ended his misconduct if MULIC had not "withdrawn" its threat to report him.

[2] As pointed out in MULIC's petitions, leading scholars of Securities law have recognized the existence and far-reaching importance of that question in this case (Pet. p. 15).

test applied by the District Court. To suggest that a less stringent test might have been applied in determining proximate cause, however, does not excuse placing the burden of proof with respect to an essential element of the plaintiff's cause of action on the defendant.[3] Whatever the proper test of causal connection, the burden of introducing proof sufficient to meet that test is on the plaintiff.

The fact that many of the findings of the lower Court which were affirmed by the Court of Appeals were reached by compounding inferences is apparent on the face of the District Court's opinion and the opinion of the majority of the Court of Appeals. The same is true with respect to the standards of review applied by the Court of Appeals in reviewing inferences drawn from undisputed evidence.

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[3] Moreover, the "facilitation" test urged by respondent has nothing to do with proximate cause. It is a test applied in some jurisdictions to determine the substantive issue of whether one is an "aider or abettor" in criminal cases. The Restatement test to which respondent refers (p. 18) is inapplicable because it requires proof of liability prior to its application.